S. Hrg. 101-134

NATURAL GAS WELLHEAD DECONTROL

HEARING

BEFORE THE

COMMITTEE ON
ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

FIRST SESSION

ON

S. 625

TO ELIMINATE ARTIFICIAL DISTORTIONS IN THE NATURAL GAS MARKETPLACE, TO PROMOTE COMPETITION IN THE NATURAL GAS INDUSTRY, AND FOR OTHER PURPOSES

S. 783

TO AMEND THE NATURAL GAS POLICY ACT OF 1978 TO ELIMINATE WELLHEAD PRICE AND NONPRICE CONTROLS ON THE FIRST SALE OF NATURAL GAS, AND TO MAKE TECHNICAL AND CONFORMING AMENDMENTS TO SUCH ACT

H.R. 1722

TO AMEND THE NATURAL GAS POLICY ACT OF 1978 TO ELIMINATE WELLHEAD PRICE AND NONPRICE CONTROLS ON THE FIRST SALE OF NATURAL GAS, AND TO MAKE TECHNICAL AND CONFORMING AMENDMENTS TO SUCH ACT

MAY 8, 1989

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NATURAL GAS WELLHEAD DECONTROL

MONDAY, MAY 8, 1989

U.S. SENATE,
COMMITTEE ON ENERGY AND NATURAL RESOURCES,
Washington, DC.

The committee met, pursuant to notice, at 10:06 a.m. in room SD-366, Dirksen Senate Office Building, Hon. J. Bennett Johnston, chairman, presiding.

OPENING STATEMENT OF HON. J. BENNETT JOHNSTON, U.S. SENATOR FROM LOUISIANA

The CHAIRMAN. The hearing will come to order.

The purpose of the committee's hearing this morning is to consider three bills that eliminate all remaining controls on natural gas production by January 1, 1993. H.R. 1722 was passed by the House of Representatives on April 17 of this year. S. 625 was introduced by Senator Nickles and Senator Ford on March 16. Joined by the ranking minority member of this committee, I introduced S. 783 on April 13. Senator Nickles and Senator Ford have joined as cosponsors of S. 783.

Apart from a single difference in the transitional provisions that apply between the date of enactment and January 1, 1993, the House and Senate bills are substantially identical. This difference can be resolved and is not an obstacle to passage, we believe.

These bills offer an historic opportunity to end 35 years of Federal regulation of natural gas at the wellhead and to complete the wellhead decontrol process that was begun with the Natural Gas Policy Act of 1978. Our experience of the past decade under NGPA has proved without a doubt that wellhead decontrol is the correct energy policy for natural gas.

Furthermore, due to the evolution of natural gas markets, the evolution of the regulatory scheme administered by the FERC, and the depletion of old gas reserves dedicated to interstate commerce, those wellhead price controls that remain in effect do little or nothing to protect the consuming public or to lower prices.

Energy experts tell us that we are poised on the verge of an era of new opportunities in natural gas. Passage of this legislation will help ensure that adequate supplies of natural gas are available at reasonable prices, so that natural gas can live up to its potential as a clean-burning, abundant and domestically available fuel for America's future.

[A prepared statement from Senator Coats and the texts of the bills follow:]

STATEMENT OF SENATOR DAN COATS ON NATURAL GAS DECONTROL

SENATE ENERGY COMMITTEE, MAY 8, 1989

Mr. Chairman, as a cosponsor of S. 783 and S. 625, I commend you for holding this hearing today. I have followed natural gas legislation for the past seven years, and five years ago, as a Member of the House Energy and Commerce Committee, I was one of a handful of Midwestern Republicans fighting decontrol. I introduced legislation, the Natural Gas Policy Act Reform Amendments oif 1983, which I hoped could be a compromise vehicle for slower decontrol.

Though as a Republican who has a natural tendency toward decontrol I have nearly always favored less government regulation, I have in the past opposed deregulation of natural gas because I felt it was not in the interest of my constituents in Indiana. I am pleased that the natural gas market has stabilized to the point where total deregulation will not adversely affect consumers in northern industrial states.

It is my hope that, in the short run, this legislation will end government control of the natural gas market without adversely affecting the price of natural gas. Indeed, there are some industry experts who believe the legislation will cause prices to go down.

In the long run, Mr. Chairman, it is my hope that cheaper and more widely available decontrolled natural gas will contribute to the energy security of the United States. The recent increases in the price of gasoline which have occurred so soon after the oil spill off the coast of Alaska plainly demonstrates that America's energy options must be carefully balanced.

Natural gas is an economical, environmentally clean form of energy. I believe this legislation will help assure market-oriented energy options. Consumers need choices, and this legislation puts the welfare of the consumer first.

This legislation enjoys widespread, indeed almost unanimous support, as is evidenced by the unanimous passage of similar legislation in the House Energy and Commerce Committee and on the House floor. I commend Senator Nickles, and you, Mr. Chairman, for your leadership on this issue.

II

101st CONGRESS
1st Session

S. 625

To eliminate artificial distortions in the natural gas marketplace, to promote competition in the natural gas industry, and for other purposes.

IN THE SENATE OF THE UNITED STATES

March 16 (legislative day, January 3), 1989

Mr. Nickles (for himself and Mr. Ford) introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources

---

A BILL

To eliminate artificial distortions in the natural gas marketplace, to promote competition in the natural gas industry, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be referred to as the "Natural Gas Regulatory Reform Act of 1989".

TITLE I—DECONTROL OF NATURAL GAS

ELIMINATION OF WELLHEAD PRICE CONTROLS

Sec. 101. Title I of the Natural Gas Policy Act of 1978 (15 U.S.C. 3311-3333) is repealed.

COORDINATION WITH THE NATURAL GAS ACT

SEC. 102. Section 601(a)(1)(A) of the Natural Gas Policy Act of 1978 (15 U.S.C. 3431(a)(1)(A)) is amended to read as follows:

"(A) APPLICATION TO FIRST SALES.—For purposes of section 1(b) of the Natural Gas Act, the provisions of the Natural Gas Act and the jurisdiction of the Commission under such Act shall not apply to natural gas solely by reason of any first sale of such natural gas.".

TECHNICAL AND CONFORMING AMENDMENTS

SEC. 103. The Natural Gas Policy Act of 1978 is amended as follows:

(1) The table of contents in section 1(b) (15 U.S.C. 3301 note) is amended by striking the items relating to title I and sections 503 and 507.

(2) Section 312(c) (15 U.S.C. 3372(c)) is amended by striking "any natural gas" and all that follows through "(3)" and inserting in lieu thereof "any natural gas".

(3) Section 315(a)(1) (15 U.S.C. 3375(a)(1)) is amended by striking "or (B)".

(4) Section 501(c) (15 U.S.C. 3411(c)) is repealed.

(5) Section 502(d) (15 U.S.C. 3412(d)) is repealed.

(6) Section 503 (15 U.S.C. 3413) is repealed.

(7) Section 504 (15 U.S.C. 3414) is amended—

(A) in subsection (a), by striking "person" and all that follows through "to otherwise" and inserting in lieu thereof "person to";

(B) in paragraph (b)(1), by striking "paragraphs (2) and (3)" and inserting in lieu thereof "paragraph (2)";

(C) by striking paragraph (b)(3); and

(D) in paragraph (b)(4), by striking "paragraph (1), (2), or (3)" and inserting in lieu thereof "paragraph (1) or (2)", and by redesignating paragraph (b)(4) as (b)(3).

(8) Section 506(d) (15 U.S.C. 3416(d)) is repealed.

(9) Section 507 (15 U.S.C. 3417) is repealed.

(10) Section 601 (15 U.S.C. 3431) is amended—

(A) by striking subparagraphs (B) and (E) of paragraph (a)(1);

(B) by redesignating subparagraphs (C) and (D) of paragraph (a)(1) as subparagraphs (B) and (C), respectively;

(C) in subparagraph (a)(1)(C) (as redesignated by subparagraph (B) of this paragraph), by striking "subparagraph (A), (B), or (C)" and inserting in lieu thereof "subparagraph (A) or (B)";

(D) by amending subparagraph (b)(1)(A) to read as follows:

"(A) FIRST SALES.—Except as otherwise provided in this subsection, for purposes of sections 4 and 5 of the Natural Gas Act, any amount paid at any first sale of natural gas shall be deemed to be just and reasonable.";

(E) in subparagraph (b)(1)(D), by striking "if such amount does not exceed the applicable maximum lawful price established under title I of this Act"; and

(F) in paragraph (c)(2), by striking "purchase of natural gas" and all that follows through "under section 202)," and inserting in lieu thereof "purchase of natural gas if, under subsection (b) of this section, such amount is deemed to be just and reasonable for purposes of sections 4 and 5 of such Act,".

(11) Section 602 (15 U.S.C. 3432) is amended by striking "(a) AUTHORITY TO PRESCRIBE" and all that follows through "(b) COMMON CARRIERS.—".

EFFECTIVE DATE OF TITLE I

SEC. 104. The provisions of title I become effective January 1, 1993.

TITLE II—TRANSITIONAL PROVISIONS

DECONTROL OF NATURAL GAS SUBJECT TO A NEWLY EXECUTED CONTRACT, A RENEGOTIATED CONTRACT, A TERMINATED CONTRACT, OR TO A CONTRACT WHICH EXPIRES

SEC. 201. Section 121 of the Natural Gas Policy Act of 1978 (15 U.S.C. 3331) is amended by the deletion of the words "Subject to the reimposition of price controls as provided in section 122, the" and inserting in lieu thereof "The", and by the addition of a new subsection (f) to read as follows:

"(f) SPECIAL RULE.—The provisions of subtitle A shall not apply to—

"(1) gas subject to any contract for the first sale of natural gas that is executed after the date of enactment of this subsection, or

"(2) gas subject to any contract for the first sale of natural gas that is renegotiated after the date of enactment of this subsection if such renegotiated contract expressly provides that the provisions of subtitle A shall not apply, or

"(3) gas subject to any contract for the first sale of natural gas that will expire, lapse, or terminate after the date of enactment of this subsection at such time as that contract expires, lapses, or terminates, or

"(4) gas previously subject to any contract for the first sale of natural gas that has expired, lapsed, or was terminated on or before the date of enactment of this subsection.".

COORDINATION WITH THE NATURAL GAS ACT

SEC. 202. Section 601(a)(1)(B) of the Natural Gas Policy Act of 1978 (15 U.S.C. 3431(a)(1)(B)) is amended by striking "or" at the end of clause (ii), by replacing the period at the end of clause (iii) with "; or" and by the addition of a new clause (iv) to read as follows:

> "(iv) natural gas exempted from the operation of subtitle A of title I pursuant to section 121(f).".

EFFECTIVE DATE OF TITLE II

SEC. 203. The provisions of title II are effective on the date of enactment of this Act.

○

II

101st CONGRESS
1st Session

S. 783

To amend the Natural Gas Policy Act of 1978 to eliminate wellhead price and nonprice controls on the first sale of natural gas, and to make technical and conforming amendments to such Act.

IN THE SENATE OF THE UNITED STATES

April 13 (legislative day, January 3), 1989

Mr. Johnston (for himself, Mr. McClure, Mr. Nickles, Mr. Ford, Mr. Bingaman, Mr. Wallop, Mr. Breaux, Mr. Wirth, Mr. Boren, Mr. Simpson, Mr. Garn, Mr. Coats, and Mr. Gramm) introduced the following bill; which was read twice and referred to the Committee on Energy and Natural Resources.

A BILL

To amend the Natural Gas Policy Act of 1978 to eliminate wellhead price and nonprice controls on the first sale of natural gas, and to make technical and conforming amendments to such Act.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be referred to as the "Natural Gas Wellhead Decontrol Act of 1989".

SEC. 2. DEREGULATION OF FIRST SALES OF NATURAL GAS.

(a) INTERIM ELIMINATION OF CERTAIN MAXIMUM LAWFUL PRICES.—Section 121 of the Natural Gas Policy Act of 1978 (15 U.S.C. 3331) is amended by adding at the end the following new subsection:

"(f) ADDITIONAL DECONTROL.—The provisions of subtitle A respecting the maximum lawful price for a first sale of natural gas shall cease to apply to natural gas described in paragraphs (1), (2), (3), and (4), as follows:

"(1) EXPIRED, TERMINATED, OR POST-ENACTMENT CONTRACTS.—In the case of natural gas to which no first sale contract applies on the date of enactment of the Natural Gas Wellhead Decontrol Act of 1989, subtitle A shall not apply to any first sale of such natural gas delivered on or after the first day after such date of enactment.

"(2) EXPIRING OR TERMINATING CONTRACTS.—In the case of natural gas to which a first sale contract applies on the date of enactment of the Natural Gas Wellhead Decontrol Act of 1989, but to which such contract ceases to apply after such date of enactment, subtitle A shall not apply to any first sale of such natural gas delivered after such contract ceases to apply.

"(3) CERTAIN RENEGOTIATED CONTRACTS.—In the case of natural gas to which a first sale contract applies on the date of enactment of the Natural Gas

Wellhead Decontrol Act of 1989, where the parties have expressly agreed in writing after March 23, 1989, that all or part of the gas sold under such contract shall not be subject to any maximum lawful price under subtitle A after a specified date, subtitle A shall not apply to any first sale of the natural gas subject to such express agreement delivered on or after the date so specified, except that subtitle A shall not cease to apply to any such natural gas pursuant to this paragraph before the date of enactment of the Natural Gas Wellhead Decontrol Act of 1989.

For purposes of this subsection, a first sale contract applies to natural gas when the seller has a contractual obligation to deliver such natural gas under such contract.".

(b) PERMANENT ELIMINATION OF WELLHEAD PRICE CONTROLS.—Title I of the Natural Gas Policy Act of 1978 (15 U.S.C. 3311–3333) is repealed, effective on January 1, 1993.

SEC. 3. TECHNICAL AND CONFORMING AMENDMENTS.

(a) AMENDMENTS EFFECTIVE UPON ENACTMENT.—The Natural Gas Policy Act of 1978 is amended as follows:

(1) The table of contents in section 1(b) (15 U.S.C. 3301 note) is amended—

(A) in the item relating to section 315, by striking "Contract duration; filing" and inserting in lieu thereof "Filing"; and

(B) by striking the item relating to section 507.

(2) Section 315 (15 U.S.C. 3375) is amended—

(A) in the section heading, by striking "**CONTRACT DURATION;**"; and

(B) by striking "(a) Contract Duration.—" and all that follows through "(b) Filing of Contracts and Ancillary Agreements.—".

(3) Section 502(d) (15 U.S.C. 3412(d)) is repealed.

(4) Section 504(b) (15 U.S.C. 3414(b)) is amended—

(A) in paragraph (1), by striking "paragraphs (2) and (3)" and inserting in lieu thereof "paragraph (2)";

(B) by striking paragraph (3); and

(C) in paragraph (4), by striking "paragraph (1), (2), or (3)" and inserting in lieu thereof "paragraph (1) or (2)".

(5) Section 506(d) (15 U.S.C. 3416(d)) is repealed.

(6) Section 507 (15 U.S.C. 3417) is repealed.

(7) Section 601 (15 U.S.C. 3431) is amended—

(A) by amending subsection (a)(1)(E) to read as follows:

"(E) CERTAIN ADDITIONAL NATURAL GAS.—For purposes of section 1(b) of the Natural Gas Act, the provisions of the Natural Gas Act and the jurisdiction of the Commission under such Act shall not apply solely by reason of any first sale of natural gas which is committed or dedicated to interstate commerce as of the day before the date of the enactment of this Act and which is not subject to a maximum lawful price under subtitle A of title I by reason of section 121(f), effective as of the date such gas ceases to be subject to such maximum lawful price."; and

(B) in subsection (c)(2), by striking "purchase of natural gas" and all that follows through "under section 202)," and inserting in lieu thereof "purchase of natural gas if, under subsection (b) of this section, such amount is deemed to be just and reasonable for purposes of sections 4 and 5 of such Act,".

(b) AMENDMENTS EFFECTIVE ON JANUARY 1, 1993.—Effective on January 1, 1993, the Natural Gas Policy Act of 1978 is amended as follows:

(1) The table of contents in section 1(b) (15 U.S.C. 3301 note) is amended by striking the items relating to title I and section 503.

(2) Section 312(c) (15 U.S.C. 3372(c)) is amended by striking "any natural gas" and all that follows through "(3)" and inserting in lieu thereof "any natural gas".

(3) Section 313 (15 U.S.C. 3373) is amended by inserting ", as such section was in effect on January 1, 1989" after "section 107(c)" both places it appears, and after "section 105(b)(3)(B)" both places it appears.

(4) Section 501(c) (15 U.S.C. 3411(c)) is repealed.

(5) Section 503 (15 U.S.C. 3413) is repealed.

(6) Section 504(a) (15 U.S.C. 3414(a)) is amended by striking "person" and all that follows through "to otherwise" and inserting in lieu thereof "person to".

(7) Section 601 (15 U.S.C. 3431) is amended—

(A) by amending subsection (a)(1)(A) to read as follows:

"(A) APPLICATION TO FIRST SALES.—For purposes of section 1(b) of the Natural Gas Act, the provisions of the Natural Gas Act and the jurisdiction of the Commission under such Act shall not apply to any natural gas solely by reason of any first sale of such natural gas.";

(B) by striking subparagraphs (B) and (E) of subsection (a)(1);

(C) by redesignating subparagraphs (C) and (D) of subsection (a)(1) as subparagraphs (B) and (C), respectively;

(D) in subsection (a)(1)(C) (as redesignated by subparagraph (C) of this paragraph), by striking "subparagraph (A), (B), or (C)" and inserting in lieu thereof "subparagraph (A) or (B)";

(E) by amending subsection (b)(1)(A) to read as follows:

"(A) First sales.—Except as otherwise provided in this subsection, for purposes of sections 4 and 5 of the Natural Gas Act, any amount paid in any first sale of natural gas shall be deemed to be just and reasonable."; and

(F) in subsection (b)(1)(D), by striking "if such amount does not exceed the applicable maximum lawful price established under title I of this Act".

(8) Section 602(a) (15 U.S.C. 3432(a)) is amended—

(A) by striking "AUTHORITY TO PRESCRIBE LOWER" and inserting in lieu thereof "AUTHORITY TO PRESCRIBE"; and

(B) by striking "which does not exceed the applicable maximum lawful price, if any, under title I of this Act".

○

II

101st CONGRESS
1st Session

H.R. 1722

IN THE SENATE OF THE UNITED STATES

April 18 (legislative day, January 3), 1989

Received; read twice and referred to the Committee on Energy and Natural Resources

---

AN ACT

To amend the Natural Gas Policy Act of 1978 to eliminate wellhead price and nonprice controls on the first sale of natural gas, and to make technical and conforming amendments to such Act.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Natural Gas Wellhead Decontrol Act of 1989".

SEC. 2. DEREGULATION OF FIRST SALES OF NATURAL GAS.

(a) Interim Elimination of Certain Maximum Lawful Prices.—Section 121 of the Natural Gas Policy

Act of 1978 (15 U.S.C. 3331) is amended by adding at the end the following new subsection:

"(f) ADDITIONAL DECONTROL.—The provisions of subtitle A respecting the maximum lawful price for a first sale of natural gas shall cease to apply to natural gas described in paragraphs (1), (2), (3), and (4), as follows:

"(1) EXPIRED, TERMINATED, OR POST-ENACTMENT CONTRACTS.—In the case of natural gas to which no first sale contract applies on the date of enactment of the Natural Gas Wellhead Decontrol Act of 1989, subtitle A shall not apply to any first sale of such natural gas delivered on or after the first day after such date of enactment.

"(2) EXPIRING OR TERMINATING CONTRACTS.—In the case of natural gas to which a first sale contract applies on the date of enactment of the Natural Gas Wellhead Decontrol Act of 1989, but to which such contract ceases to apply after such date of enactment, subtitle A shall not apply to any first sale of such natural gas delivered after such contract ceases to apply.

"(3) CERTAIN RENEGOTIATED CONTRACTS.—In the case of natural gas to which a first sale contract applies on the date of enactment of the Natural Gas Wellhead Decontrol Act of 1989, where the parties have expressly agreed in writing after March 23, 1989, that all or part of the gas sold under such contract shall not be subject to any maximum lawful price under subtitle A after a specified date, subtitle A shall not apply to any first sale of the natural gas subject to such express agreement delivered on or after the date so specified, except that subtitle A shall not cease to apply to any such natural gas pursuant to this paragraph before the date of enactment of the Natural Gas Wellhead Decontrol Act of 1989.

"(4) NEWLY SPUDDED WELLS.—In the case of natural gas produced from a well the surface drilling of which began after March 23, 1989, subtitle A shall not apply to any first sale of such natural gas delivered on or after the first day after the date of enactment of the Natural Gas Wellhead Decontrol Act of 1989.

For purposes of this subsection, a first sale contract applies to natural gas when the seller has a contractual obligation to deliver such natural gas under such contract.".

(b) PERMANENT ELIMINATION OF WELLHEAD PRICE CONTROLS.—Title I of the Natural Gas Policy Act of 1978 (15 U.S.C. 3311–3333) is repealed, effective on January 1, 1993.

SEC. 3. TECHNICAL AND CONFORMING AMENDMENTS.

(a) AMENDMENTS EFFECTIVE UPON ENACTMENT.—The Natural Gas Policy Act of 1978 is amended as follows:

(1) The table of contents in section 1(b) (15 U.S.C. 3301 note) is amended—

(A) in the item relating to section 315, by striking "Contract duration; filing" and inserting in lieu thereof "Filing"; and

(B) by striking the item relating to section 507.

(2) Section 315 (15 U.S.C. 3375) is amended—

(A) in the section heading, by striking "**CONTRACT DURATION;**"; and

(B) by striking "(a) CONTRACT DURATION.—" and all that follows through "(b) FILING OF CONTRACTS AND ANCILLARY AGREEMENTS.—".

(3) Section 502(d) (15 U.S.C. 3412(d)) is repealed.

(4) Section 504(b) (15 U.S.C. 3414(b)) is amended—

(A) in paragraph (1), by striking "paragraphs (2) and (3)" and inserting in lieu thereof "paragraph (2)";

(B) by striking paragraph (3); and

(C) in paragraph (4), by striking "paragraph (1), (2), or (3)" and inserting in lieu thereof "paragraph (1) or (2)".

(5) Section 506(d) (15 U.S.C. 3416(d)) is repealed.

(6) Section 507 (15 U.S.C. 3417) is repealed.

(7) Section 601 (15 U.S.C. 3431) is amended—

(A) by amending subsection (a)(1)(E) to read as follows:

"(E) CERTAIN ADDITIONAL NATURAL GAS.—For purposes of section 1(b) of the Natural Gas Act, the provisions of the Natural Gas Act and the jurisdiction of the Commission under such Act shall not apply solely by reason of any first sale of natural gas which is committed or dedicated to interstate commerce as of the day before the date of the enactment of this Act and which is not subject to a maximum lawful price under subtitle A of title I by reason of section 121(f), effective as of the date such gas ceases to be subject to such maximum lawful price."; and

(B) in subsection (c)(2), by striking "purchase of natural gas" and all that follows through "under section 202)," and inserting in lieu thereof "purchase of natural gas if, under subsection (b) of this section, such amount is deemed to be just and reasonable for purposes of sections 4 and 5 of such Act,".

(b) AMENDMENTS EFFECTIVE ON JANUARY 1, 1993.—Effective on January 1, 1993, the Natural Gas Policy Act of 1978 is amended as follows:

(1) The table of contents in section 1(b) (15 U.S.C. 3301 note) is amended by striking the items relating to title I and section 503.

(2) Section 312(c) (15 U.S.C. 3372(c)) is amended by striking "any natural gas" and all that follows through "(3)" and inserting in lieu thereof "any natural gas".

(3) Section 313 (15 U.S.C. 3373) is amended by inserting ", as such section was in effect on January 1, 1989" after "section 107(c)" both places it appears, and after "section 105(b)(3)(B)" both places it appears.

(4) Section 501(c) (15 U.S.C. 3411(c)) is repealed.

(5) Section 503 (15 U.S.C. 3413) is repealed.

(6) Section 504(a) (15 U.S.C. 3414(a)) is amended by striking "person" and all that follows through "to otherwise" and inserting in lieu thereof "person to".

(7) Section 601 (15 U.S.C. 3431) is amended—

(A) by amending subsection (a)(1)(A) to read as follows:

"(A) APPLICATION TO FIRST SALES.—For purposes of section 1(b) of the Natural Gas Act, the provisions of the Natural Gas Act and the jurisdiction of the Commission under such Act shall not apply to any natural gas solely by reason of any first sale of such natural gas.";

(B) by striking subparagraphs (B) and (E) of subsection (a)(1);

(C) by redesignating subparagraphs (C) and (D) of subsection (a)(1) as subparagraphs (B) and (C), respectively;

(D) in subsection (a)(1)(C) (as redesignated by subparagraph (C) of this paragraph), by striking "subparagraph (A), (B), or (C)" and inserting in lieu thereof "subparagraph (A) or (B)";

(E) by amending subsection (b)(1)(A) to read as follows:

"(A) FIRST SALES.—Except as otherwise provided in this subsection, for purposes of sections 4 and 5 of the Natural Gas Act, any amount paid in any first sale of natural gas shall be deemed to be just and reasonable."; and

(F) in subsection (b)(1)(D), by striking "if such amount does not exceed the applicable maximum lawful price established under title I of this Act".

(8) Section 602(a) (15 U.S.C. 3432(a)) is amended—

(A) by striking "AUTHORITY TO PRESCRIBE LOWER" and inserting in lieu thereof "AUTHORITY TO PRESCRIBE"; and

(B) by striking "which does not exceed the applicable maximum lawful price, if any, under title I of this Act".

Passed the House of Representatives April 17, 1989.

Attest: DONNALD K. ANDERSON,

Clerk.

The CHAIRMAN. We have a large group of witnesses. Before I get into those witnesses, do my colleagues wish to make a statement? Senator Nickles.

STATEMENT OF HON. DON NICKLES, U.S. SENATOR FROM OKLAHOMA

Senator NICKLES. Mr. Chairman, I have a lengthy statement I will insert for the record, but just a couple of comments.

One, I am very pleased that we are here and pleased that this will be the year, 1989, that we have finally deregulated natural gas. I hope that is the case. I expect it is the case.

It is long overdue. It is 35 years late, but better late than never. Congress, when it has tried to regulate gas, maybe had good intentions, but it had bad results. It was not effective for the consumer. It did not assist the consumer.

The net result was shortages, the net result was in some cases distorted markets. And Congress passed the Natural Gas Policy Act in 1978. Again, maybe good intentions, but we had about 33 different price categories for gas.

As everyone on this committee is aware, we only decontrolled one category of gas at that time, the so-called deep gas, and at that time there was a shortage because of previous price controls and you had a lot of attention in that area. So gas prices really went up in that one decontrolled area and as a result you had billions of dollars invested.

Also, when the supply and demand equalized itself those gas prices fall. As a result, we saw Penn Square fall, we saw Continental Illinois, a large bank, fell. We have seen depression in the oil and gas States, primarily as a result of the Natural Gas Policy Act of 1978 did not do the job. It did not decontrol enough gas.

It limited that decontrol to one small category of gas, and then we saw those prices rise rather rapidly and also fall rather rapidly. That was a serious mistake.

We have a chance to clean up, I guess, some of the past errors, and that is by doing what we should have done before 1978 and that is decontrolling all natural gas. I think it can be done. I think it will have a positive impact for consumers and also for the industry.

I think the natural gas industry has a very bright future and decontrol in all aspects will certainly be to its benefit. So I am pleased that we are here. I am happy to cosponsor a bill with you and also with Senator Ford that will achieve that objective.

I am pleased that the House of Representatives has already passed nearly identical legislation, and I look forward to its speedy conclusion.

[The prepared statement of Senator Nickles follows:]

STATEMENT OF SENATOR DON NICKLES
HEARING BEFORE THE COMMITTEE ON ENERGY AND NATURAL RESOURCES ON BILLS TO AMEND THE NATURAL GAS POLICY ACT

May 8, 1989

Mr. Chairman, we have seen a lot of changes in the natural gas industry since the last time this Committee considered decontrolling wellhead gas prices. During the past five years, gas prices have fallen dramatically, the transportation gas for others by pipelines has blossomed, and, most significantly, the vast majority of domestic natural gas has been effectively decontrolled.

The Congress began the process of decontrol by providing in the Natural Gas Policy Act of 1978 for the decontrol of "new" gas beginning January 1, 1985, and "infill" gas beginning July 1, 1987. Following both decontrol dates, the average wellhead price for domestic natural gas fell as free market mechanisms replaced arbitrary pricing categories. EIA estimates that 61 percent of domestic gas was decontrolled by 1988. The past four years of increasing decontrol since 1985 have helped to order gas markets.

The most frequently given rationale for continued price controls is to "protect" the consumer from higher prices. However, with more than 60 percent of natural gas decontrolled, the prices consumers pay will reflect the marketplace, not the price ceilings on the one-third of the gas that remains under price controls. Moreover, only a minority of the domestic gas that is still subject to price controls is selling at prices below current market prices.

According to the Energy Information Administration, the amount of "effectively decontrolled" domestic gas, i.e. gas that is both decontrolled gas and gas which has a maximum lawful price above market prices, has grown from approximately 23% in 1983 to over 94% in 1988.

Clearly, today's price controls on natural gas do not "protect" the consumer. In fact, there is evidence that consumers are actually paying higher prices for gas than they would in the absence of price controls.

The continued existence of federal price controls on natural gas is distorting investment decisions, reducing the flexibility of the gas market to evolve, and requiring enormous administrative costs to be borne by producers, pipelines and even the FERC. Chairman Hesse was reported to have told reporters last month that if our wellhead decontrol legislation becomes law, one hundred or more jobs at the FERC would be eliminated in the well certification division alone.

On March 16, 1989, Senator Ford and I, joined by our Committee colleagues, Senators Garn, Wallop and Bingaman, introduced S. 625. Our bill contained a transition period period lasting until full decontrol on January 1, 1993. During the transition period, our bill would decontrol gas that is not subject to contracts, i.e., gas under contracts that expire or are renegotiated with reference to decontrol during the transition period. Moreover, the full decontrol under the bill would be achieved by repealing Subtitle A of the NGPA, the wellhead price ceiling authority, rather than by abrogating producer/purchaser gas supply contracts. Accordingly, decontrol would be achieved only as contemplated by the parties to the gas contracts, such as by triggering the operation of a "decontrol provision" written into the contracts by the parties in contemplation of possible federal decontrol. Thus, both the transition period and the full decontrol provisions of our bill would avoid contract abrogation.

Our bill has served as the model for the House-passed bill and for the Johnston/McClure/Nickles/Ford bill, S. 783, which I fully support. There is, however, one difference between the two Senate bills and the

House-passed bill. The House bill contains a provision in the transition period that would immediately decontrol gas from any well spudded after date of enactment.

In drafting the Nickles/Ford bill and in joining Senator Johnston on his bill, I made a conscious decision not to make exceptions to the "decontrol by mutual agreement" policy underlying the transition period in our two bills. I specifically rejected the "newly spudded" wells concept in drafting S.625, as being highly inequitable and bad energy policy.

The spudded wells provision is inequitable in that it would single out for special harm the very people who are currently adding to our nation's gas supplies, the producers who are planning to drill for more gas. Many of these producers have already made investments in purchasing farmouts or other subcontract rights to drill in existing fields, they have taken out loans and have contracted for equipment. It is unfair for the Congress to abruptly change the rules on these investors after their reliance on existing FERC price rules and the underlying Congressional incentives in the NGPA. These producers deserve adequate notice of a change in the rules.

The spudded well provision is also a step backward toward the NGPA's discredited policies of market tinkering. The provision would treat molecules of gas from one well differently than the existing law (and the existing contract) would treat molecules of gas from another well, even if the gas were from the same formation. It is this very type of government meddling in contracts and distorting free-market decisionmaking that we are trying to correct by repealing Subtitle A of the NGPA.

Thank you, Mr. Chairman. I look forward to hearing the comments of today's witnesses.

The CHAIRMAN. Thank you very much, Senator Nickles. You have certainly been a strong leader in this movement prior to this year. For many years we have worked on this issue together.

Senator Metzenbaum.

STATEMENT OF HON. HOWARD M. METZENBAUM, U.S. SENATOR FROM OHIO

Senator METZENBAUM. Deja vu. Here we are again.

How wonderful it is going to be to decontrol the price of natural gas, decontrol natural gas totally. And what I like about this bill is that it is Alice in Wonderland. The tooth fairy is going to come down from above and is going to take care of all the producers, the distributors, and somehow along the line the consumers are going to be well provided for as well.

The House passed the bill unanimously. It absolutely shocked me, because I have not seen the evidence nor heard the evidence to convince me that the consumer will not once again be getting the short end of the deal.

This is a momentous piece of legislation: bang-bang, let us go, we have got to get it through in a hurry. I read quotes from various experts in the field, talk about shortages and what is going to happen in the next year if there is a severe winter, what is going to happen to consumers.

This bill unquestionably will have a tremendous impact on producers, the pipelines, and the utilities. The burden of proof is on those who support this legislation to prove what the impact will be on the consumers of this country, and unless that burden of proof can be maintained to convince this Senator that the consumers will not get the short end of the stick once again, I intend to oppose it. That is not to say that I will oppose it, but I want to be convinced and as of this moment, Mr. Chairman, I am not convinced.

This legislation disrupts the regulatory compact that has been established between buyers and sellers of natural gas. And in proposing a fundamental re-ordering of the regulatory compact, one might expect that all parties will come out better.

Frankly, that does not appear to be the case. The legislation, momentous legislation in the area of natural gas, does not contain a single word, a single passage, a single subparagraph, for natural gas consumers—nothing, zero, zip.

No relief from smothering take-or-pay bills; no refunds for consumers when the Federal Energy Regulatory Commission finds that pipelines have been unjustly overcharging; no safeguards against large industrials bypassing the local distribution companies, leaving higher and higher bills behind for residential and small commercial customers;

No support for low income customers, consumers, to help them meet higher bills as prices climb, or to help them insulate their homes as supplies tighten; no leverage for consumers to use on producers to renegotiate favored nation or other oppressive contract clauses; no opportunities to help consumers get out from under high-priced contracts until 1993.

Proponents of decontrol claim that the free market will benefit everyone. Bring in the violins. That is the music I have been hearing around here for years: The free market will help the consumers.

They point to the dramatic change of the natural gas industry since January 1, 1985. Let us not kid ourselves. Who is part and parcel of the natural gas industry in a leadership role? The very same oil companies that are ripping off and gouging the American people now, with no reason whatsoever.

They used the *Valdez* incident, the *Valdez* travesty, for the purpose of raising their prices. And we are to look to those same oil companies and that crowd to protect the American consumer? Come on, who are you kidding?

I remain skeptical that these bills would decontrol natural gas prices in much the same way that FERC has administratively decontrolled large parts of the natural gas industry, offering little relief for the consumers. FERC has been authorizing pass-throughs of take-or-pay costs disproportionally to residential consumers without ever reviewing whether the pipelines were imprudent in signing these oppressive contracts.

Frankly, I did not expect that much from FERC, when you look at the recent appointees to that body. And similarly, this legislation currently has no take-or-pay relief. New FERC regulations permit producers to abandon their obligation to supply customers with gas, supplies that the Supreme Court has ruled they must continue to provide.

This legislation further frees producers to abandon their obligation to serve, without giving pipelines or their customers a market-out.

FERC has refused to decontrol immediately unreasonably high incentive prices for certain gas, although it has had the power to do so and for years has said it intended to do so.

This legislation also does not immediately decontrol high priced gas now, when energy prices are relatively low. The rosy predictions for life under decontrol rest on one dubious assumption: that supplies of natural gas will remain as available and as affordable as they have been in the eighties.

When we debated decontrol in the seventies, we knew that gas was in tight supply. Proved reserves have been declining since the mid-1960's. And while I certainly hope that supplies remain available, there are many reasons and many authorities who expect demand to outstrip supply in the nineties.

The Energy Information Administration predicts that demand will grow by 15 percent in the next decade. This will certainly result in sharply climbing prices.

Harbingers of change surfaced at a hearing that I chaired 3 weeks ago on the dramatic gasoline price spikes. A host of energy pundits claimed that pump prices have been led by increases in the price of crude oil from $14 to over $20 per barrel since November 1988.

The oil to gas fuel-switching ability of large industrials could send natural gas prices dramatically higher soon. As a consequence of this 50 percent oil price rise, residential bills will rise in turn, and the next hearing season will evoke outcries of concern from consumers.

Yet, while large producing states would reap rewards from higher wellhead prices and increased severance taxes, the poor and those on fixed incomes in consuming states would not have any safety net.

Every day there is new evidence of the big oil companies grabbing up the natural gas industry even more, by swallowing up independents, as well as through exploration. Amoco is now the largest gas producer in North America and Exxon, Texaco, Shell are close behind.

We know that big oil ripped us off on the gasoline price hikes, as I said a minute ago, and I am not comfortable in expecting them not to do the same with respect to natural gas.

We have several witnesses before us today who will argue that decontrol is beneficial and others who think that as currently written it is a raw deal. I come to this hearing skeptical, but with a willingness to listen as to the long-term impact of this legislation.

I am in no hurry to pass this legislation now or if it comes to the Senate floor. I will need answers to my questions and, more importantly, I will need to be assured that consumers will not again get the shaft while the rest of the industry is getting all the benefits of this bill.

Other than that, I have nothing to say, Mr. Chairman. [Laughter.]

The **CHAIRMAN**. Senator Metzenbaum, I have sometimes seen you wrong, but you are always open-minded. [Laughter.]

And I think when you hear the evidence today you will find that your pals at Exxon have less to do with this natural gas decontrol than you think, and I hope you will be able to join us.

Senator **METZENBAUM**. I intend to sit through the whole hearing.

[The prepared statement of Senator Metzenbaum follows:]

STATEMENT OF SENATOR HOWARD METZENBAUM ON NATURAL GAS DECONTROL, MAY 8, 1989

TODAY WE ARE CONSIDERING A MAJOR, PERHAPS A MOMENTOUS, PIECE OF LEGISLATION. THE NATURAL GAS WELLHEAD DECONTROL ACT OF 1989, AND THE OTHER BILLS BEFORE US CAN HAVE A TREMENDOUS IMPACT ON PRODUCERS, PIPELINES, GAS UTILITIES, AND CONSUMERS FOR YEARS AND DECADES TO COME.

THIS LEGISLATION DISRUPTS THE REGULATORY COMPACT THAT HAS BEEN ESTABLISHED BETWEEN BUYERS AND SELLERS OF NATURAL GAS. IN PROPOSING A FUNDAMENTAL REORDERING OF THE REGULATORY COMPACT ONE MIGHT EXPECT THAT ALL PARTIES WILL COME OUT BETTER. BUT THAT DOES NOT APPEAR TO BE THE CASE.

THIS LEGISLATION DOES NOT CONTAIN A SINGLE WORD, A SINGLE PASSAGE, A SINGLE SUB-PARAGRAPH FOR NATURAL GAS CONSUMERS -- NOTHING. NO RELIEF FROM SMOTHERING TAKE-OR-PAY BILLS -- NO REFUNDS FOR CONSUMERS WHEN THE FEDERAL ENERGY REGULATORY COMMISSION (FERC) FINDS THAT PIPELINES HAVE BEEN UNJUSTLY OVERCHARGING -- NO SAFEGUARDS AGAINST LARGE INDUSTRIALS BYPASSING THE LOCAL DISTRIBUTION COMPANIES, LEAVING HIGHER AND HIGHER BILLS BEHIND FOR RESIDENTIAL AND SMALL COMMERCIAL CUSTOMERS -- NO SUPPORT FOR LOW-INCOME CONSUMERS TO HELP THEM MEET HIGHER BILLS AS PRICES CLIMB, OR TO HELP THEM INSULATE THEIR HOMES AS SUPPLIES TIGHTEN -- NO LEVERAGE FOR CONSUMERS TO USE ON PRODUCERS TO RENEGOTIATE FAVORED-NATION OR OTHER OPPRESSIVE CONTRACT CLAUSES -- NO OPPORTUNITIES TO HELP CONSUMERS GET OUT FROM UNDER HIGH-PRICED CONTRACTS UNTIL 1993.

PROPONENTS OF DECONTROL CLAIM THAT THE QUOTE UNQUOTE FREE MARKET WILL BENEFIT EVERYONE. THEY POINT TO THE DRAMATIC CHANGES IN THE NATURAL GAS INDUSTRY SINCE 1/1/85.

BUT I REMAIN SKEPTICAL. THESE BILLS WOULD DECONTROL NATURAL GAS PRICES IN MUCH THE SAME WAY THAT FERC HAS ADMINISTRATIVELY DECONTROLLED LARGE PARTS OF THE NATURAL GAS INDUSTRY: OFFERING LITTLE RELIEF FOR CONSUMERS.

FERC HAS BEEN AUTHORIZING PASS-THROUGH OF TAKE-OR-PAY COSTS DISPROPORTIONATELY TO RESIDENTIAL CONSUMERS -- WITHOUT EVEN REVIEWING WHETHER THE PIPELINES WERE IMPRUDENT IN SIGNING THOSE OPPRESSIVE CONTRACTS. SIMILARLY, THIS LEGISLATION CURRENTLY HAS NO TAKE-OR-PAY RELIEF.

NEW FERC REGULATIONS PERMIT PRODUCERS TO ABANDON THEIR OBLIGATION TO SUPPLY CUSTOMERS WITH GAS -- SUPPLIES THAT THE SUPREME COURT HAS RULED THEY MUST CONTINUE TO PROVIDE. THIS LEGISLATION FURTHER FREES PRODUCERS TO ABANDON THEIR OBLIGATION TO SERVE -- WITHOUT GIVING PIPELINES OR THEIR CUSTOMERS A MARKET-OUT.

FERC HAS REFUSED TO DECONTROL IMMEDIATELY UNREASONABLY HIGH INCENTIVE PRICES FOR CERTAIN GAS ALTHOUGH IT HAS HAD THE POWER TO DO SO -- AND FOR YEARS HAS SAID IT INTENDED TO DO. THIS LEGISLATION ALSO DOES NOT IMMEDIATELY DECONTROL HIGH-PRICED GAS NOW, WHEN ENERGY PRICES ARE RELATIVELY LOW.

THE ROSY PREDICTIONS FOR LIFE UNDER DECONTROL REST ON ONE DUBIOUS ASSUMPTION: THAT SUPPLIES OF NATURAL GAS WILL REMAIN AS AVAILABLE AND AFFORDABLE AS THEY HAVE BEEN IN THE '80S. WHEN WE DEBATED DECONTROL IN THE '70S WE KNEW THAT GAS WAS IN TIGHT SUPPLY -- PROVED RESERVES HAVE BEEN DECLINING SINCE THE MID-'60S. AND WHILE I CERTAINLY HOPE THAT SUPPLIES REMAIN AVAILABLE, THERE ARE MANY REASONS TO EXPECT DEMAND TO OUTSTRIP SUPPLY IN THE '90S -- THE ENERGY INFORMATION ADMINISTRATION PREDICTS THAT DEMAND WILL GROW BY 15 PERCENT IN THE NEXT DECADE. THIS WILL CERTAINLY RESULT IN SHARPLY CLIMBING PRICES.

HARBINGERS OF CHANGE SURFACED AT A HEARING I CHAIRED THREE WEEKS AGO ON THE DRAMATIC GASOLINE PRICE SPIKES. A HOST OF ENERGY PUNDITS ARGUED THAT PUMP PRICES HAVE BEEN LED BY INCREASES IN THE PRICE OF CRUDE OIL FROM $14 TO OVER $20 PER BARREL SINCE NOVEMBER 1988. THE OIL-TO-GAS FUEL-SWITCHING ABILITY OF LARGE INDUSTRIALS COULD SEND NATURAL GAS PRICES DRAMATICALLY HIGHER SOON AS A CONSEQUENCE OF THIS 50 PERCENT OIL PRICE RISE. RESIDENTIAL BILLS WILL RISE IN TURN -- AND IN THE NEXT HEATING SEASON WILL EVOKE OUTCRIES FROM CONSUMERS.

YET WHILE LARGE PRODUCING STATES WOULD REAP REWARDS FROM HIGHER WELLHEAD PRICES AND INCREASED SEVERANCE TAXES, THE POOR AND THOSE ON FIXED INCOMES IN CONSUMING STATES WOULD NOT HAVE ANY SAFETY NET.

EVERY DAY THERE IS NEW EVIDENCE OF THE BIG OIL COMPANIES GRABBING THE NATURAL GAS INDUSTRY -- BY SWALLOWING UP INDEPENDENTS, AS WELL AS THROUGH EXPLORATION, AMOCO IS NOW THE LARGEST NATURAL GAS PRODUCER IN NORTH AMERICA, AND EXXON, TEXACO, SHELL ARE CLOSE BEHIND. WE KNOW THAT BIG OIL RIPPED US OFF ON THE GASOLINE PRICE HIKES -- AND NOW WE ARE OPENING UP YET ANOTHER AVENUE FOR THEM TO LINE THEIR POCKETS AT CONSUMERS' EXPENSE.

WE HAVE SEVERAL WITNESSES BEFORE US TODAY WHO WILL ARGUE THAT DECONTROL IS BENEFICIAL AND OTHERS WHO THINK THAT AS CURRENTLY WRITTEN IT'S A RAW DEAL. I COME TO THIS HEARING SKEPTICAL BUT WITH AN OPEN MIND AS TO THE LONG-TERM IMPACT OF THIS LEGISLATION.

I AM IN NO HURRY TO PASS THIS BILL, NOW, OR IF IT COMES TO THE FLOOR OF THE SENATE. I WILL NEED ANSWERS TO MY QUESTIONS. AND, MORE IMPORTANTLY, I WILL NEED TO BE ASSURED THAT CONSUMERS WILL ALSO BENEFIT FROM ANY LEGISLATION WE MIGHT PASS.

The CHAIRMAN. Senator Metzenbaum.

STATEMENT OF HON. JEFF BINGAMAN, U.S. SENATOR FROM NEW MEXICO

Senator BINGAMAN. Thank you, Mr. Chairman.

I would say that was a statement by an undecided voter. I will go ahead and indicate that I do support your legislation. As you know, I am cosponsoring both your bill and Senator Nickles' bill, and I believe the time for complete decontrol of natural gas prices at the wellhead has come.

I think that price controls at the wellhead are an anachronism. I do believe this legislation would benefit consumers and I believe that we are going to need a very responsive natural gas market to meet the demands for natural gas that are forecast for the next decade.

I want to mention one aspect of the legislation that is of concern to some of my constituents, and that is the impact on tight sands gas. There is an unavoidable consequence of this decontrol legislation, which as a result of the way the Tax Code is presently written, it would eliminate the tight sands credit.

But the legislation that we consider today in no way reflects an adverse judgment on the desirability of that credit. I hope the Finance Committee will take up the various pieces of legislation that have been put forward by myself and others to extend the tight sands credit, as well as the credit for other non-conventional fuels.

I look forward to seeing this legislation move quickly, Mr. Chairman.

Thank you.

[The prepared statement of Senator Bingaman follows:]

OPENING STATEMENT
OF
SENATOR JEFF BINGAMAN
HEARING ON
S. 783, S. 625 AND H.R. 1722
MAY 8, 1989

The time for complete decontrol of natural gas prices at the wellhead has come. As a cosponsor of S. 783 and S. 625, I fully support legislation to amend the Natural Gas Policy Act of 1978 to eliminate all remaining wellhead price controls by January 1, 1993.

Our experience with partial wellhead decontrol under the NGPA and with the total decontrol of crude oil prices has proven unquestionably that energy markets respond favorably, both in terms of price and in terms of supply, to free market forces. Price controls at the wellhead are a regulatory anachronism, as proven by the fact that natural gas is the only commodity that remains subject to federal price controls at its source.

This legislation will benefit consumers, because the elimination of remaining wellhead price controls will the increase competition in the natural gas industry that has been fostered by partial wellhead decontrol under the NGPA and by the Federal Energy Regulatory Commission's open access initiatives and other pro-competitive policies. Looking ahead, removal of the distorting influence of wellhead price controls is important, because fully responsive natural gas markets will be necessary to meet the demand for natural gas that is forecasted for the decade ahead.

The **Chairman**. Thank you, Senator Bingaman.
Senator Conrad.

STATEMENT OF HON. KENT CONRAD, U.S. SENATOR FROM NORTH DAKOTA

Senator **Conrad**. Very briefly, Mr. Chairman, I appreciate this opportunity to comment upon legislation to decontrol the price of natural gas.

One of my principal concerns is the relationship of this legislation to the gas purchase contracts at the Great Plains synthetic fuels project near Beulah, ND. As the chairman knows from having visited that facility, four pipeline companies have long-term contracts with the project to purchase the full output of synthetic gas from that plant.

Those contracts set the price of the gas based upon a formula linked to certain other energy prices. The contracts were submitted to and approved by the Federal Energy Regulatory Commission under FERC Opinion 119. That opinion provides that the purchasers could recover the costs of the contracts on a rolled-in basis.

I want to make it clear that Congress does not intend to affect the gas purchase contracts at the Great Plains synthetic fuels project with the natural gas decontrol legislation that is before us today. So as we move through this process, Mr. Chairman, I want to make sure that we establish a clear record that the Federal Government's revenue stream that was anticipated from that deal and the revenue stream of the project itself are not inadvertently affected.

With that, Mr. Chairman, I look forward to the excellent witnesses you have lined up for us today.

[The prepared statement of Senator Conrad follows:]

Kent Conrad

STATEMENT OF SENATOR KENT CONRAD

BEFORE THE SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES

MAY 8, 1989

Thank you, Mr. Chairman. I appreciate this opportunity to comment upon legislation to decontrol the price of natural gas.

One of my principal concerns is the relationship of this legislation to the gas purchase contracts at the Great Plains Synthetic Fuels Project near Beulah, North Dakota.

Four pipeline companies have long-term contracts with the Project to purchase the full output of synthetic gas. Those contracts set the price of the gas based upon a formula linked to certain other energy prices. The contracts were submitted to and approved by the Federal Energy Regulatory Commission under FERC Opinion 119. That opinion provides that the purchasers could recover the costs of the contracts on a rolled-in basis.

I want to make it clear that Congress does not intend to affect the gas purchase contracts at the Great Plains Synthetic Fuels Project with the natural gas decontrol legislation that is before us today.

Thank you, Mr. Chairman.

The **Chairman**. Thank you, Senator Conrad.

Senator Ford.

STATEMENT OF HON. WENDELL H. FORD, U.S. SENATOR FROM KENTUCKY

Senator **Ford**. Thank you, Mr. Chairman.

I think the attendance on an off day indicates the interest in this piece of legislation. I am very pleased that you are holding hearings today, and I want to make it very clear that I support the Senate version of this bill. The unconventional gas is not deregulated until January 1, 1993.

If you remember, a couple of years ago we tried to set 1993 as the decontrol date, and hopefully we can finally by January 1, 1993, get it deregulated.

The **Chairman**. I have a statement here on behalf of Senator McClure and Senator Burns for the record.

[The prepared statements of Senator McClure and Senator Burns follow:]

STATEMENT OF SENATOR JAMES A. McCLURE
RANKING REPUBLICAN MEMBER

COMMITTEE ON ENERGY AND NATURAL RESOURCES
HEARING ON S. 625, S. 783 AND H.R. 1722
May 8, 1988

Today the Committee on Energy and Natural Resources is holding a legislative hearing on S. 625, S. 783, and H.R. 1722, which propose to deregulate natural gas at the wellhead.

These three bills are essentially identical; each proposes to complete on January 1, 1993 the task of deregulating natural gas initiated in 1985 by the Natural Gas Policy Act. There are some differences between these bills, but in my opinion they are relatively minor.

We now are at a crossroads. We can choose to hold onto the last vestiges of wellhead controls brought about by the Supreme Court's 1954 Phillips decision, or instead, we can take the final step toward a market-regulated natural gas supply.

Returning natural gas production to the discipline of the marketplace has in fact been underway for more than a decade. It began, in part, with the 1978 enactment of the Natural Gas Policy Act. But it is largely attributable to a host of FERC regulatory actions, most notably the establishment in 1985 of the so-called "open access transportation program" (Order No. 436/500).

Less than five years ago, virtually all natural gas was subject to wellhead controls, just as nearly all gas was marketed only by pipelines. Consumers relied upon pipelines to acquire the supplies of gas they needed at prices they hoped would be reasonable.

Today it is entirely different. A minority of our gas supply is still subject to Federal wellhead controls; and consumers themselves now purchase the bulk of natural gas in the field either directly or through brokers. And much of the gas which is still subject to wellhead price controls, is controlled in name only; the marketplace has largely made those price ceilings non-binding.

The industry trend is clear. Pipelines are getting out of the natural gas merchant business either intentionally or because of the desires of their customers to do their own purchasing. Pipelines are instead increasingly acting only as a transporter of gas for other persons. Last year more than two-thirds of interstate pipeline throughput was customer-owned gas, and that share will undoubtedly continue to increase.

While the benefits of a market-regulated natural gas supply are clear, so are the implications: the government can no longer be counted on to step in to ameliorate the vicissitudes of supply and demand. It will now be up to consumers to ensure that they have adequate supplies of natural gas prices they consider reasonable.

The path towards a market-regulated natural gas supply has not been easy, nor has it been without problems. For example, the transition has resulted in a multi-billion dollar run-up in take-or-pay, which is now just being dealt with by FERC. And there may still be potholes out there. The Federal courts have already struck down the Commission's open access transportation program once, and it is still under legal assault. For example, just a few days ago briefs were filed in Federal court by pipelines and local distribution companies urging that the "interim" open access transportation rule (Order No. 500) be reversed and remanded back to the Commission due to inadequacies. And many of the other FERC natural gas regulatory actions, such as Order No. 451, are similarly under legal challenge, or will soon be. At this time it is not clear whether the various key Commission orders and individual decisions will withstand legal review.

Despite these problems, today the legislative prospects for eliminating remaining Federal wellhead regulation look very bright. A wellhead deregulation bill has passed the House of Representatives unanimously, despite long-standing statements that that would occur only over someone's dead body. And today, as never before, there is near unanimity in support of decontrol.

Major and independent gas producers, interstate pipelines, local distribution companies, industrial end users and consumer groups all generally agree that decontrol would be in the overall national interest.

Those who do not support the pending legislation, some of whom will testify today, do not oppose it because they believe that decontrol would increase gas prices; there is general agreement that decontrol would have little, if any, upward impact on gas prices. Instead, they oppose the legislation because of the issues it does not address. However, there is no question that if extraneous amendments are adopted, particularly those which deal with the so-called LDC bypass issue, action on decontrol legislation would have to wait for another Congress.

One final note. The natural gas industry, from drill-tip to burner-tip, has undergone a virtual revolution over the past decade. Although the industry, particularly pipelines, have made heroic efforts to adjust to the new regulatory climate, that process is not yet complete. The Commission should now devote its time, attention, and efforts to implementing and fine tuning the existing regulatory structure, rather than embarking on new regulatory initiatives which seek to make additional fundamental changes. For example, the Commission has yet to issue a final order establishing open access transportation. Order No. 500 is still an "interim" order, despite the passage of nearly two years: A final order is long overdue. Another example of Commission action urgently needed is the implementation of gas inventory charges.

At some time it may be necessary for the Commission to make further fundamental changes to the regulatory system, but those efforts should be reserved for the future. It is time now for there to be some modicum of regulatory stability.

In conclusion, I support the wellhead deregulation of natural gas, and I prefer the formulation of the two pending Senate bills. My support for that legislation, however, is contingent on the absence of extraneous amendments.

Conrad Burns

COMMITTEE ON ENERGY AND NATURAL RESOURCES

HEARING ON S.783, S.625, and H.R.1722

By Senator Conrad Burns

Thank you Mr. Chairman. As a natural gas producing state, this issue is particularly important to Montana and I'm very interested in hearing what the witnesses have to say. I must say, though, that it's nice to consider, for a change, a bill with as little controversy attached to it as this one appears to have.

Everyone seems to agree that decontrol of natural gas is a good idea. Large industrial consumers appear convinced that it will lead to lower natural gas prices and there seems to be a lot of support for this position. Lower natural gas prices should lead to lower consumer prices on a wide variety of manufactured goods. That should make America more competitive in the world marketplace and that's good for everyone.

But perhaps even more important, most natural gas producers seem to think that decontrol will ultimately stimulate exploration for new resources. At a time when domestic natural gas exploration is declining and our need is increasing, it's important to create a financial climate that encourages industry in exploration. We have to reduce our dependency on foreign sources of energy. Companies need to be able to base their exploration decisions on the economic merit of the project without consideration of artificial controls.

But if everyone does agree on decontrol, there seems to be some disagreement on how to to get there. So I guess today I'd like to get a better idea of how these experts view, not only the concept of decontrol, but also the road to decontrol. I want to hear their projections and concerns, and I look forward to to their statements.

Thank you Mr. Chairman for the opportunity to make these remarks.

The **Chairman**. And with that, we will begin with our first panel. I would like to welcome Allen Wampler, Assistant Secretary for Fossil Fuels in the Department of Energy, and Mr. William Scherman, Chief of Staff, Office of the Chairman of FERC.

Mr. Wampler.

STATEMENT OF J. ALLEN WAMPLER, ASSISTANT SECRETARY FOR FOSSIL ENERGY, DEPARTMENT OF ENERGY, ACCOMPANIED BY KENNETH MALLOY, OFFICE OF POLICY

Mr. **Wampler**. Thank you, Mr. Chairman. Mr. Chairman, members of the committee:

To my left I have Ken Malloy, who is in our Policy Office at DOE, with me to assist in answering questions.

I am pleased to have the opportunity to discuss the Department's position on legislation to decontrol natural gas wellhead prices. We have a unique opportunity this year to forge a bipartisan consensus that will end the 35-year era of Federal regulation of the natural gas industry. Your leadership, Mr. Chairman, will be instrumental in convincing your colleagues that the changing structure of the gas market is fostering increased competition which can be accelerated, to the benefit of consumers, by completing the decontrol of wellhead gas prices. Speaking for Secretary Watkins and the Department, I want to congratulate you, along with members of your committee on both sides of the aisle, for your initiative in building a workable consensus in support of decontrol.

The product of this bipartisan effort, if successful, will be the restoration of market forces in an industry that can play an expanding role in meeting our Nation's energy and environmental goals without imposing financial burdens on the energy consumers.

Since the U.S. Supreme Court upheld Federal regulation of the gas industry in the *Phillips* decision in 1954, this Nation has suffered from the distortions, complexities, shortages, and inefficiencies of Federal natural gas price controls. In partial response, the Congress enacted the Natural Gas Policy Act of 1978. The act was intended to help balance natural gas supply and demand by encouraging discovery and production of new gas supplies. It provided for a very complicated, phased decontrol of the wellhead price of certain types of newly discovered gas. To help contain consumer prices, the NGPA kept price controls on gas discovered before April 1977. Thus, while the NGPA created incentives to produce high-cost new gas, it prolonged disincentives for full production of low-cost old gas.

Gradually, as the NGPA permitted the phaseout of price controls on some categories of gas, the Nation began to witness the healthy and beneficial restoration of competition to the natural gas industry brought about by market pricing.

But even under the NGPA's phaseout, certain categories of gas will remain under Federal price controls indefinitely. Gas still controlled includes both "old gas" and some categories of new gas. Between 35 and 40 percent of current domestic gas production is estimated to remain under Federal regulation.

In the interest of relieving the natural gas industry and consumers from this continuing costly regulatory burden and in the interest of furthering competition in the industry, all remaining wellhead price controls should be removed. In his first budget message to America, President Bush expressed the belief that "at long last the Federal Government should fully decontrol natural gas."

We are pleased to note the consensus-building that occurred in the House of Representatives, which resulted in the passage of the natural gas wellhead decontrol bill. That bill, H.R. 1722, as well as Senate bills S. 625 and S. 783, would essentially eliminate the remaining natural gas wellhead price controls as contracts expire or are renegotiated, with all controls to be eliminated by January 1, 1993. This position represents a consensus that is supported by producers, pipelines, and local distribution companies alike. The Department of Energy has advocated that the sooner wellhead price controls are removed, the better. But in the interest of keeping the consensus intact, we can support the January 1, 1993, date for total elimination of natural gas wellhead price controls. We are aware that there are some differences in the House and Senate versions of the decontrol bills. We view those differences as minor differences and would be extremely disappointed if they were allowed to escalate. We trust that these differences can be resolved expeditiously and we hope to see a bill on the President's desk prior to the summer recess.

The elimination of remaining wellhead price controls will contribute to a healthy and competitive natural gas industry. Deregulation will foster timely and market-responsive price signals which, in turn, will encourage increased exploration and production activities. This will help ensure that reliable supplies of natural gas remain available to consumers. Finally, competition will objectively and efficiently ensure that consumers pay the lowest prices consistent with long-term supply reliability.

The natural gas resource base in the United States is vast. A recent Department of Energy study found that we have a 35-year supply of natural gas at current consumption rates with costs of less than three dollars per thousand cubic feet. Even greater quantities exist at higher prices.

Natural gas can make significant contributions to our domestic energy security, while helping to preserve our environmental heritage. But to achieve these benefits, efficient pricing, production and use of natural gas are essential and long overdue. The Department of Energy therefore supports the emerging bipartisan consensus to deregulate all remaining natural gas wellhead prices.

This completes my statement, Mr. Chairman. I would be pleased to answer any questions you or your committee members may have.

The CHAIRMAN. Thank you, Mr. Wampler.

Mr. Scherman.

STATEMENT OF WILLIAM S. SCHERMAN, CHIEF OF STAFF, FEDERAL ENERGY REGULATORY COMMISSION, ACCOMPANIED BY SUSAN COURT, ASSOCIATE GENERAL COUNSEL FOR OIL AND GAS

Mr. SCHERMAN. Thank you. Mr. Chairman and members of the Committee:

On behalf of Chairman Hesse, I am pleased to have the opportunity this morning to discuss the chairman's view of, and support for, the pending legislation to complete the decontrol of natural gas wellhead prices. I am joined this morning by Susan Court, the Commission's Associate General Counsel for Oil and Gas.

As you know, in the past few years the Commission has made a great deal of progress in implementing and promoting policies which have contributed to a major realignment of the natural gas industry. The industry is more competitive today than ever and natural gas consumers are the beneficiaries.

Along these lines, I would like to briefly highlight some of the significant steps the Commission has taken to give all consumers and shippers greater service options.

Today, 20 of the major 23 interstate natural gas pipelines are open access transporters, and the other three are in the process of becoming open access transporters. As a result, over 90 percent of the Nation's interstate natural gas throughput is carried on open access pipelines. As part of this effort, the Commission has recently put in place nondiscriminatory procedures for pipelines operating on the Outer Continental Shelf. In addition, many of the regulatory impediments to the movement of gas from one market to another have been reduced. Finally, certain price distortions have been eliminated by collapsing all vintages of old gas into a single price category.

The progress the Commission has made in these areas complements the competitive forces at the wellhead that Congress set in motion when it passed the NGPA. This has resulted in a more efficient and competitive natural gas industry. According to EIA, between 1985 and 1988 the average wellhead price of natural gas decreased by 32 percent. The complete decontrol of wellhead prices here would provide another major step toward allowing the discipline of the competitive market to determine natural gas prices.

As you know, S. 783 and S. 625 are in effect identical. Both are similar to H.R. 1722. All three bills provide for the complete decontrol of natural gas still subject to price regulation on January 1, 1993. The bills also provide for phased decontrol until that time in certain specified situations.

First, if a wellhead contract has already expired or has been terminated before enactment, then the gas under such a contract is decontrolled on the day after enactment.

Second, gas under any new wellhead contract entered into after enactment is also decontrolled.

Third, all gas under contracts which expire or otherwise end after enactment are decontrolled as of the time the contracts terminate.

Contracts renegotiated after March 23, 1989, the date when decontrol legislation was first introduced, are treated like new contracts and the gas is decontrolled according to the terms of the new provisions.

Mr. Chairman and members of the committee, Chairman Hesse has long been on record as supporting total wellhead decontrol. She firmly believes that the Nation's energy needs are best served by permitting competitive forces to work through the marketplace to maintain the appropriate balance between price and supply.

Chairman Hesse supports you, Mr. Chairman, and the efforts of this committee to consider the removal of unnecessary and outmoded restraints on natural gas so that the Nation's energy future may be guided to the greatest extent possible by the market. The three decontrol bills currently before you represent a major step in that direction.

We urge all interested parties to seize the moment and work together to reach a consensus position so that we can finally achieve the elimination of unnecessary price controls.

Thank you.

The CHAIRMAN. Thank you very much, gentlemen.

We have to make our questioning fairly quick. These two witnesses, I think we ought to maybe go a 7-minute limit, and I would urge Senators not to use the full 7. After that we will have to go to a 5-minute limit because we do have a large number of witnesses.

Senator METZENBAUM. Mr. Chairman.

The CHAIRMAN. Yes?

Senator METZENBAUM. I do not wish to question your ruling and I agree with it, but I must say that there is only one person in this committee at this moment that I know of that has some concerns about this bill. I am not sure about Senator Bumpers, but I know that——

Senator BUMPERS. You certainly are not.

Senator METZENBAUM. I did not mean to—I did not know you were there, Dale, sorry.

The CHAIRMAN. We will try to give you what you need.

Mr. Wampler, you said 35 to 40 percent of the gas is under controls now. Actually it is a lot less under effective control, that is under controls that actually lower the price of natural gas, is that not correct?

Mr. WAMPLER. Yes, that is correct, Mr. Chairman. Of the 6.5 trillion cubic feet of controlled gas that was sold in 1988, only about 1 trillion cubic feet of that was sold at the price ceiling. So effectively there is much, much less than that percentage.

The CHAIRMAN. About 6 percent, is that correct?

Mr. WAMPLER. About 6 percent, that is correct.

The CHAIRMAN. Of the gas is under control.

And what is the control price of that which is under control?

[Pause.]

Mr. WAMPLER. Mr. Chairman, we will have an answer for you in a second.

[Pause.]

Mr. WAMPLER. It is around $1.40, Mr. Chairman, $1.40, $1.60.

The CHAIRMAN. $1.40, $1.60. And what is the price of natural gas on the market now, let us say 102 gas?

Mr. WAMPLER. Anywhere from $1.75 to $2.

The CHAIRMAN. $1.75 to $2? I did not think it was that high.

Ms. COURT. Senator, the maximum lawful price for 102(d) gas as published by the FERC is $5.27.

The CHAIRMAN. I know, I am talking about the market price.

Ms. COURT. I think you are talking about the 104?

The CHAIRMAN. I am talking about the market price, what are they getting.

Ms. **Court**. The market price, the average market price, the average wellhead price at the end of 1988 for the year 1988 was $1.71.

The **Chairman**. But it has come down this spring. The information I had, it is selling at considerably less than that now.

Ms. **Court**. That may be, Senator. The information that we are using is the information published by the EIA, and we have it for the average for 1988.

Senator **Nickles**. The EIA says the average for 1988 was $1.71?

Ms. **Court**. Yes, sir.

The **Chairman**. Let me ask Danny Conklin back there. What is gas selling at now?

Mr. **Conklin**. In the area of about $1.35, Senator, $1.40.

The **Chairman**. That is the information I had, all right. If gas is selling for $1.35 to $1.40 and six percent of the gas is under regulation now, then if we took those regulations off today presumably the market would be above or equal to what that regulated price is, is that not correct?

Mr. **Wampler**. That is correct.

The **Chairman**. Did you get that, Senator Metzenbaum? Six percent of the gas is under contract, the NGPA—I mean, six percent of the gas is under regulation, effective regulation. The price of that is about $1.40, and the market is now $1.35 to $1.40.

So that presumably it would have no effect on the price, save for one phenomenon, and that is the phenomenon of contracts where controls expire and contract prices would have to go up to the nearest—to the top price in the market. Am I correct in that?

Mr. **Wampler**. That is correct. I think that we should note, Mr. Chairman, that we have done some pretty exhaustive analysis of this whole situation, the EIA especially has, and it is really impossible for anybody to predict pricing. We have had a long history of not being able to do that in this country.

But all the pressures that we see being brought to bear on this remaining bit of gas are downward pressures. So I think that there is nothing that would lead us to believe nationwide that you would see any trend of upward pressures on the prices.

All the factors——

The **Chairman**. Well, answer my question, though. I mean, what I have set for you is this: that the regulated price is $1.35 to $1.40, the market price is $1.35 to $1.40. Therefore taking off that control would have absolutely no effect today, save for one phenomenon and that is the phenomenon of contracts that contain provisions which say that it goes up to the highest allowable price or such similar provisions as that.

Are we right so far?

Mr. **Wampler**. That is right.

The **Chairman**. Now, under our bill you have until January the 1st, 1993, before those kick in, and many of those contracts expire, do they not?

Mr. **Wampler**. Yes, they do, Mr. Chairman.

The **Chairman**. In fact, do not most of those—we are talking about that six percent now. Do not most of those expire within the next three years?

Mr. **Wampler**. Yes, they do.

The CHAIRMAN. Do you have any figures on what percentage of those would expire?

Mr. WAMPLER. Yes, we do. Just a moment, please.

[Pause.]

Mr. WAMPLER. The American Gas Association is estimating that about 66 percent of those contracts will expire by 1994.

The CHAIRMAN. So that actually you are only dealing with maybe something like two percent of the gas that could be subject to this phenomenon of going up with reference to a contractual price?

Mr. WAMPLER. It is a very small number, yes.

Senator FORD. 66 percent of the volume.

The CHAIRMAN. Yes. Is that 66 percent of the volume?

Mr. WAMPLER. By volume, that is correct.

The CHAIRMAN. Okay. Now, what percent of gas is used, commercial gas, is used in dual fuel-capable facilities?

Mr. WAMPLER. We have two different estimates, Mr. Chairman. I simply do not know.

Senator FORD. Split it.

Mr. WAMPLER. Well, from 30 to 60 percent. So if we can say it was 45, that might be reasonably accurate.

The CHAIRMAN. 30 to 60.

All right, does not the price of competing fuels really set the price of natural gas?

Mr. WAMPLER. Yes, it does.

The CHAIRMAN. Next I want to know what the big companies, Exxon, et cetera, what do they have to do with the price of natural gas?

Mr. WAMPLER. Well, that would be really impossible to answer, because we at this point do not even actually have accurate information on who owns all the natural gas. We could not very easily get that.

But I think the market determines the price of gas, and I think the more you decontrol the market the more determination that is going to have in the establishment of the price.

The CHAIRMAN. My statistics indicate that there are approximately 3,000 individual gas producers in existence and that in 1987 the largest U.S. gas producer, Texaco, produced only 4.5 percent of total U.S. production. Does that sound right to you?

Mr. WAMPLER. That sounds right, yes.

The CHAIRMAN. I think the answer is Exxon has got nothing to do with the price of natural gas. They sell into the market like everybody else does, and the market is effectively set by the price of competing fuels. And if you went way up with the price of one category of gas, you would have to go down with another category, because sort of the weighted average price is going to be determined by that price of competing fuels.

I think Senator Nickles was first. Senator Nickles.

Senator NICKLES. Well, I will be happy to yield to Senator Domenici. You have not made a statement yet.

Senator DOMENICI. I have plenty of time this morning. Go ahead.

Senator NICKLES. Mr. Chairman, thank you. Just a couple of comments.

Mr. Wampler, I noticed in your statement you mention that since we have partially decontrolled natural gas that natural gas prices have declined, is that correct?

Mr. WAMPLER. That is correct.

Senator NICKLES. And just looking at EIA's statement, their selected price at the wellhead, I notice that natural gas prices—we in effect decontrolled several categories of gas beginning in '85. I am looking at prices in '84. Average wellhead price for the year '84 was $2.66, in '85 it was $2.51, in '86 is $1.94, '87 and '88 $1.67, $1.71, is that correct?

Mr. WAMPLER. That is correct.

Senator NICKLES. So the more we decontrolled natural gas or since we have decontrolled natural gas, prices have come down, is that correct?

Mr. WAMPLER. That is correct.

Senator NICKLES. Now, Congress also decontrolled, and/or the Administration decontrolled, oil prices back in what, '80, '81. And have not oil prices also declined dramatically in that same period?

Mr. WAMPLER. They have.

Senator NICKLES. I just wanted the Senator from Ohio to be aware of those facts.

Thank you. I have no further questions, Mr. Chairman.

The CHAIRMAN. Senator Metzenbaum.

Senator METZENBAUM. Mr. Wampler, you say in your opening statement that deregulation will send price signals that will encourage increased exploration and development. Is that not another way of saying that substantially higher prices will be the trigger for increased exploration?

Mr. WAMPLER. No, Senator. I think that what that says is that the supply and demand in the situation without regulation will, certainly, determine production and prices.

Senator METZENBAUM. Well, how do you react to the statement of John Sawhill, who certainly is on your side on the issue of decontrol? But he is quoted as saying: "The market should be freed of controls, which would send prices up and would signal producers to accelerate their exploratory drilling."

Is he wrong?

Mr. WAMPLER. Well, I would not agree with Mr. Sawhill's statement, with the exception of his support of deregulation. I think that with the amount of gas that is effectively deregulated at this point in time that, irrespective of deregulation, you are going to have probably the same set of market circumstances, with the exception of deregulation really clearing up more of the market to more effectively respond to supply and demand.

I think that it will have to be a positive effect. With all the natural gas that is effectively decontrolled at this point in time, I think what he was saying was that, if you do have a supply problem, you have it irrespective of deregulation. If you deregulate, it will tend to help alleviate any supply problems.

Senator METZENBAUM. But he says also that: "The supply of gas on the spot market will diminish next winter by as much as 40 to 50 percent." Do you disagree with that statement?

Mr. WAMPLER. I have no idea where he is getting his numbers. I have not seen similar numbers, Senator Metzenbaum.

Senator **Metzenbaum**. Do you disagree with Mr. Stalon of FERC, who is quoted as saying that he worries about the volatility of the market for consumers?

Mr. **Wampler**. Well, I think we all have to be concerned with the volatility of all these energy markets. But I think that that is an issue that really is not attached to deregulation, except again that deregulation is going to send some pretty positive signals. More exploration will result and the consumer will become more aware that there are abundant supplies of natural gas.

We try to get that message out in the Department, that there are 35 years of natural gas at three dollars or less in this country. I doubt that that message has been spread very well.

But we think that deregulation will help stabilize the situation.

Senator **Metzenbaum**. Mr. Wampler, the average wellhead price for flowing gas today——

The **Chairman**. Excuse me for interrupting.

Senator **Metzenbaum**. I said that he is for decontrol. Yes, he is for decontrol.

We are talking about whether Mr. Sawhill, what his position is. I know he is for decontrol. That is the reason that I think his testimony, his comment becomes even more significant.

The average wellhead price for flowing gas today is substantially below two dollars per thousand cubic feet. Deputy Secretary Henson Moore testified at my gasoline price hike hearing that oil prices had moved up 50 percent since November and warned that product prices will continue to increase as a result.

What would the average wellhead gas price be if translated into the price of a barrel, the cost of a barrel of oil today?

Mr. **Wampler**. I would have to run a set of numbers, and I could furnish you with an estimate based on historical data.

[The information follows:]

COMPARATIVE WELLHEAD PRICES OF NATURAL GAS AND OIL

If crude oil and gas were perfect substitutes, the price of an MMBtu of gas would be the same as an MMBtu of oil. No one, however, claims that crude oil and gas are perfect substitutes. The following historical table shows that over the last five years gas prices have been anywhere from 54% to 80% of crude oil prices on an MMBtu basis.

	Lower 48 States Crude Oil Average Wellhead	Natural Gas Average Wellhead	Price Ratio
1983	$28.00	$2.59	0.54
1984	$27.59	$2.66	0.56
1985	$25.74	$2.51	0.57
1986	$14.13	$1.94	0.80
1987	$16.83	$1.67	0.58
1988	$14.15a	$1.71	0.70

a: Estimated.

Gas competes with different oil products in different markets, as well as with other alternate fuels, such as coal, and conservation. In some markets it competes with #2 fuel oil and others #6. Different buyers will switch from gas to oil at different prices, not at any one specific price. Additionally, much fuel switching will depend on transportation and processing or refining charges for gas and oil. Thus, determining the impact of oil prices on gas prices is much more complicated than simply looking at MMBtu equivalents.

Senator METZENBAUM. Would you disagree if I told you that, based upon the numbers we have run, that would be about $3.75 per thousand cubic feet?

Mr. WAMPLER. I think it would be difficult to come out with a real definitive number because, while these prices do track and there is inter-fuel competition, they do not always track exactly.

So it is hard to make that statement flat-out that they would rise to that level.

Senator METZENBAUM. I did not say it would rise to that. I did not say it would rise to that. I said it would have a tendency to do so, because would not increased demand from fuel-switchable gas customers like large industrial and electric utilities bid up the price of gas to near the energy equivalent of oil, as the Energy Information Administration and others predict?

Mr. WAMPLER. You could have some tracking, and it is entirely proper that fuels should track each other in an open market.

Senator METZENBAUM. And as a matter of fact, will not captive gas customers even have to pay a premium over those prices to get secure long-term supplies, to be sure that they can heat their homes and businesses?

Mr. WAMPLER. It would be almost impossible for me to predict, because almost all of our number runs, Senator, have been on national numbers and national trends. There could be possibly some localized glitches caused by that, we certainly admit that.

But looking at national trends, you see very positive effects from deregulation, and that is why I think we have to look at it.

Senator METZENBAUM. Do you think that decontrol is a conservation measure?

Mr. WAMPLER. I think decontrol has some very attractive environmental benefits. I think it also has some very attractive energy security benefits.

I think that you are going to see the opportunity for gas to be used more and more in things like co-firing with coal, for example, in plants to provide part of an environmental answer. I think that freeing up natural gas also displaces imports of foreign oil.

I think from those two aspects it has some excellent features.

Senator METZENBAUM. Mr. Scherman, your opening statement points to FERC's achievements over the past five years in changing the natural gas industry for the benefit of gas consumers. Yet captive consumers are being saddled with a major share of take-or-pay bills, while FERC has refused to invoke its investigative powers under the Natural Gas Act, as a Court of Appeals actually urged, in order to determine whether these gas supply contracts were imprudent.

Why has not FERC used its NGA Section 5 powers to find the pipelines imprudent for signing 80 to 90 percent take-or-pay contracts or to remove the oppressive take-or-pay clauses from contracts?

Mr. SCHERMAN. Senator Metzenbaum, the Commission's response to the court's AGD decision was Order No. 500. Order No. 500 contained a number of features designed to address the take-or-pay situation.

One part was the so-called equitable sharing mechanism to deal with past take-or-pay problems. Another part was the so-called crediting mechanism designed to deal with current take-or-pay. And the third part was consideration of gas inventory charges which we hope will prevent the future accumulation of take-or-pay.

You correctly note that the court asked the Commission to reassess its decision not to invoke its authority under NGA Section 5. In Order No. 500, the Commission expressly stated that it would undertake this reassessment. Order No. 500 is an interim rule. We hope to issue a final rule some time this year.

Senator METZENBAUM. Mr. Scherman, FERC has issued two new rules, Orders 451 and 490, both of which are now being tested in the courts. They permit producers to raise the price of old, cheap gas and unilaterally abandon their obligation to supply customers after the expiration of their contracts.

Yet the Supreme Court has ruled more than once that producers have a Natural Gas Act obligation to continue to provide gas supplies to their customers upon contract expiration.

How will Orders 451 and 490 ensure the supply security that the Supreme Court ruled was Congress' intent in the Natural Gas Act, and why should producers now get to collect windfall profits on old gas that was profitably developed years ago?

Mr. SCHERMAN. Senator, I think that the Supreme Court cases that you are probably referring to were pre-NGPA cases. When the Commission issued its abandonment rules in Order No. 490, both in its notice of proposed rulemaking and in the final rule, we noted that the regulatory framework upon which the Court viewed those service obligations had been changed dramatically by the NGPA.

For example, one of the reasons underlying the Commission's rigid abandonment rules prior to the passage of the NGPA was to ensure that at the expiration of a contract gas could not be taken off of the interstate market to the intrastate market, where they could command a higher price. The NGPA eliminated that distinction.

We have found that the rigid abandonment rules do not ensure to any one given market service obligations to maintain supply. Rather, they simply inhibit the market from effectively and efficiently responding to shortages when they exist.

So that under our abandonment rules, supplies can go to those markets where they are needed.

Senator METZENBAUM. Two short questions for the two of you. Within one year after this Act becomes effective, if it becomes the law, would natural gas prices go up or will they go down, and to what extent, in your opinion? I know that there is no way to predict it with accuracy. Your opinion?

Mr. SCHERMAN. Senator, again my opinion would be that within one year there would not be a price increase for natural gas as a result of this bill being enacted.

Senator METZENBAUM. You predict that there will not be a price increase for natural gas.

Mr. SCHERMAN. On an industry-wide basis, we do not foresee an increase in the price of natural gas from the bill. Now, there may be on individual pipelines because of the nature of their contracts, that there may be individual instances where that does not hold true.

But on an industrywide basis, we do not foresee price increases as a result of this bill becoming law.

Senator METZENBAUM. Consumers across the board will not be paying higher prices, is that what you are saying?

Mr. SCHERMAN. Yes.

Senator METZENBAUM. Mr. Wampler, do you have an opinion?

Mr. WAMPLER. I agree with that. I think that prices will not increase as a result of the legislation in the short term. I think there would, very likely, be a slight decrease.

Senator METZENBAUM. A slight decrease?

Mr. WAMPLER. To the consumer overall, nationwide.

Senator METZENBAUM. Now, you are both professionals and you are prepared to stake your reputations on those representations?

Mr. WAMPLER. I think that, again, all the information that I have at this point shows that there is going to be a downward pressure by all these factors. I do not think there is going to be a dramatic decrease in prices, but I think we are going to see possibly a slight decrease and certainly not an increase overall, nationwide, of prices immediately.

Senator METZENBAUM. Thank you.

Senator NICKLES. Could I? As a result of the legislation?

Mr. WAMPLER. Right, as a result of passing the bill.

Senator METZENBAUM. Do I understand the Senator from Oklahoma to be making a distinction, that there may very well be a price increase, but that you will not be able to attribute it to the fact of the legislation?

Senator NICKLES. No, I just think it is ludicrous for us to be guessing what the prices are going to be, because there are a lot of factors that are involved, as the Senator knows.

But I think I wanted to make sure that the panel was clear that this legislation will in their opinion, and certainly in this Senator's opinion, will not have any upward pressure on prices. There may be some other events that may cause some pressure on prices that is beyond this panel's control.

Senator METZENBAUM. I want to say to my colleague that he and these two witnesses are far better authorities on the subject than I, but I predict prices will go up within the year.

Senator NICKLES. I might ask the Senator, did he predict oil prices, gasoline prices, would be climbing very rapidly when we decontrolled oil and maybe two dollar gasoline?

Senator METZENBAUM. Well, at one time it appeared that there might be, that is correct. [Laughter.]

At one time we were going down that road. But we all know that the Arab oil producing nations, as they produced more and more and sent more into this country, the American oil industry was not in a position to hold up prices.

But we do not have that situation with respect to natural gas. There is a distinction.

The CHAIRMAN. Senator Domenici.

STATEMENT OF HON. PETE V. DOMENICI, U.S. SENATOR FROM NEW MEXICO

Senator DOMENICI. Thank you, Mr. Chairman.

Let me first say that I was not here when we opened and I would not have had very much of an opening statement, but I will say that, having been here in the Senate, this is my seventeenth year, I can vividly remember the first bill I got on was a bill to deregulate natural gas 17 years ago.

It seems to me that we have finally come full circle and we are going to do something significant. From what I can tell out there, the energy picture in the United States is pretty bleak.

If there is a bright spot, it is the natural gas picture in this country, and it can get better. As you look out there, the Natural Gas Policy Act, which was very complicated, passed during the Carter Administration. It was not supposed to work, but it did work. And essentially it has problems, but where it worked was in those areas where essentially we deregulated.

We got an awful lot of new natural gas on board. Those prophets of gloom—I did not bother to go back and get some of them, but I think it is fair to say, Mr. Chairman, when that debate occurred we were already supposed to be out of natural gas by now, either that or it was supposed to be so expensive that we would probably leave it underground to use in the future for its great chemical qualities, rather than as a source of energy.

And now it is one of America's real bright spots in terms of our growing energy dependence. If we can put this bill together in an appropriate manner, it will continue to be that.

And because we do not have the rest of an energy policy put together, it certainly should not detract from our moving ahead in trying to get rid of as many of the problems as we can in natural gas development and distribution. It will not solve them all, because you cannot solve all the problems created from the mishmash of on again, off again regulation and partial deregulation and attempts by Congress and FERC to do something when we really only did a little bit.

But essentially, if we can solve this one we will move natural gas into an arena where in the next eight to ten years this Senator believes it will be a very significant contributor to America's game plan for minimizing our dependence.

Having said that, let me ask. There is one provision in the House bill that somewhat disturbs me because I think it is inconsistent with the philosophy of the bill. We tried deregulation a few years ago, and some of you are aware that we got hung up on the issue of abrogation of contracts, how far would we go and how far would we not go. And then we tried to Christmas tree it and solve all kinds of problems. That issue was so complicated that indeed it did kill our previous efforts.

So in my opinion it raises its head again in the House bill in their definition of "newly spudded," that provision which would indicate that, as I gather it, any well drilled after March 23rd, '89, but before the '93 date, would not get the treatment that would have been expected in my opinion of old gas.

I wonder, and I first ask the Administration's witness. I do not want to ask whether you generally support the abrogation of natural gas contracts, because I am not so sure you need to have that philosophy to be concerned about the "newly spudded" provision.

But might I ask, do you not construe the "newly spudded" provision, which has an after-March 23rd, 1989, date in it, to be a rather arbitrary abrogation of at least some natural gas contracts prior to and in a different manner than others are going to be treated by this bill, Mr. Secretary?

Mr. **Wampler**. Well, Senator Domenici, in all honesty the Administration would highly prefer to stay out of the spudded well issue. Our problem is we think it has some fairly minor substantive concern.

We also do not want to see anything unravel the consensus. And I think that, you are right, the last attempts, a lot of items were thrown into the debate and the consensus unraveled.

I think that we are not going to take a position on that issue. I think that it is certainly for this body to work out. But we have a great deal of concern that this issue not unravel the consensus that we have seen built in this case.

Senator **Domenici**. Well, Mr. Secretary, far be it from me to want to push you or the President into a position that apparently are indicating he now has, that he does not want to get into this argument.

But I think it is pretty fair to say that the issue of abrogation of contracts is a delicate one and that indeed it has within it the potential for—it had before—for destroying chances at a deregulation process to commence some time in the future.

The previous Administration seemed to not be concerned or to, rather, build some complicated framework around that issue, so complicated that by the time we were finished it died of its own weight.

And I assume that one of the reasons you are for this bill, in addition to it being good energy policy, is that the abrogation of contracts, which we all ought to be concerned about, seems to be workable in the manner described if we can solve the spudded issue, that is the time when we would call—when we would determine that activity came within the purview or not.

Would you tend to agree with that?

Mr. **Wampler**. I can agree with that, Senator.

Senator **Domenici**. Let me ask one last question, Mr. Chairman, of the FERC representative. Many producers have been calling, Mr. Chairman, for FERC to look at comprehensive rate reform.

[Subsequent to the hearing Mr. Wampler submitted the following:]

Committee on Energy and Natural Resources:

As a witness before the Committee on Energy and Natural Resources on May 4, 1989, I request that the following information be included in the hearing record:

Page	Line (s)	Proposed Wording
51	2-3	That is an average of the equity interests in each of the currently producing zones pursuant to our current unit plan contract, so that is agreed to by both parties. These equity percentages can be revised under the contract and any such revision is retroactive to 1942. If there is a disagreement between Chevron and the U.S. on the appropriate equity percentages, the Secretary of Energy has the authority to resolve the dispute unilaterally.
51	7	That's not necessarily true -- we plan to negotiate a new unit plan contract with Chevron prior to divestiture which would address the equity issue and many others.

I understand that this material may be inserted in the transcript in the form of an appendix for correction/clarification and referred to by footnote in the main text.

for

J. Allen Wampler
Assistant Secretary for
Fossil Energy
U. S. Department of Energy

Senator DOMENICI. In my opinion, FERC has focused on rate restructuring only, and most of that at the distribution end of the business. For example, we no longer have a "minimum bill," which helped assure a long-term supply of gas. This legislation is an obvious opportunity to look into this legislation.

Do we need to do that, or is FERC going to do it? Perhaps after contemplation the Chairman might join me in a letter to FERC urging them to take a comprehensive look at the rate reform issue.

Might you address that, please?

Mr. SCHERMAN. Sure. Chairman Hesse over the last several months has indicated that the Commission will be looking at the rate design issue over the next several months. We expect that to happen. Work is already under way to look at various rate design ideas and I think you can see the Commission taking some movement on that in the next three or four months.

Senator DOMENICI. Thank you very much.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Ford.

Senator FORD. Conrad.

The CHAIRMAN. Senator Conrad.

Senator CONRAD. Thank you, Mr. Chairman.

I would like to ask Mr. Wampler if he anticipates that this legislation would have any impact upon the revenue stream to the Great Plains synthetic fuel project?

Mr. WAMPLER. No, I would not anticipate that it would at all, Senator.

Senator CONRAD. Do you anticipate any effect on the revenue stream to the Federal government?

Mr. WAMPLER. No, I would certainly expect none at all. I would certainly hope not, because that revenue stream can amount to as much as $500 million within the next 20 years.

Senator CONRAD. And what is the reason that you anticipate no effect on the revenue stream to the Federal government or the project as a result of this legislation?

Mr. WAMPLER. Well, I think this legislation simply does not address, if you will, the tax provisions that the plant is operating under and thus would have no effect on it.

Senator CONRAD. I understand that FERC is reviewing policy with respect to the effect of corporate reorganizations, and I would ask this question of Mr. Wampler and Mr. Scherman. They have been reviewing policy with respect to the effect of corporate reorganizations on the non-jurisdictional marketing of natural gas.

Specifically, I understand that one of the companies that purchases gas from the Great Plains synthetic fuels project recently requested interim authority to transfer its jurisdictional sales service obligation to its non-jurisdictional marketing affiliates.

I would ask first Mr. Wampler if you would support a FERC policy that says that corporate reorganizations do not provide a basis for contract abrogation?

Mr. WAMPLER. Let me answer this way, Senator. We have and will express concern to FERC that nothing, no action they take, has a negative impact on the contracts that are in place with Great Plains. I think it is important from a national policy standpoint, and it is important from a revenue standpoint back to the U.S. Treasury, that we not do that.

The details of how we do that, we are in the process right now of doing a final evaluation in the Department, whether to do it by letter, whether to do it by intervention, whether to do it by some other method. But we certainly would hope that FERC would be very sensitive to this issue when they are required to make a ruling that could affect it.

Senator CONRAD. I appreciate that response and I appreciate the responsiveness of your office and also the responsiveness of Henson Moore, the Deputy Secretary, on this question when I have talked with him, talked to you both personally about it.

Let me ask Mr. Scherman. We have a situation in which there are four takers of the gas from that project, one of them being Transcontinental Gas Pipe Line, which has requested interim authority to transfer its jurisdictional sales service to its non-jurisdictional market affiliate, Temco. Now, potentially, if that were to become reality, Transcontinental would no longer make sales of natural gas to its jurisdictional customers and then would no longer have a purchase gas adjustment.

What would be your assessment of FERC's response to a situation like that one? In other words, what we have here is a situation in which the price of gas that is received by the synthetic fuels project is based upon the sales, contract sales, of Transcontinental. If they shift over to Temco and are no longer are in the gas business, you could be presented with a situation in which they assert they have no way of determining what the price of gas ought to be from that facility.

Ms. COURT. Senator, if I may. The arrangement that you have described is part of a settlement that Transco filed not too long ago, about six weeks ago. The comments and the reply comments have just come in on that, and so it is pending Commission consideration.

It is a contested matter and it would be inappropriate for us to say how the Commission would decide, one, whether to allow it or not; and then, two, just what the ramifications are for Great Plains.

Just academically speaking, it may be that Great Plains needs to—if the Commission were to approve that—and I do not know what the Commission would do and cannot predict what they would do—it appears as if they have a surrogate and they would need to come up with a different surrogate.

But at the present time, the actual proposal which you have described is pending Commission action.

Senator CONRAD. Well, let us talk academically then, because we have got a lot at stake here. The Federal government has a lot of stake, my state has a lot at stake. And I am going to be interested in taking a very long time on this legislation if we do not get answers that give us comfort.

So tell me academically, what would you do if you were in our position?

Ms. COURT. Senator, I suspect that the various parties in this proceeding have filed comments on this. So I would think that your state and Great Plains already have their positions on record. I am sorry to say I do not know what those positions are. I am not familiar with their comments, and we would be more than happy to supply for the record the summary of the comments that have been filed with respect to this issue.

Senator CONRAD. Well, I would be interested in having that, but I would also be interested in having some indication from FERC. Clearly, this would be an unintended consequence of an action that is being taken apparently for some other reason.

I would be very interested in seeing what FERC's analysis of this situation is, and it is going to be very central to my position on this legislation. And I would hate to have a determination have to be made because people say, well, we cannot really comment on that because it is a matter before the Commission.

Well, this bill is before the Congress. I unfortunately cannot take that kind of position. I have to decide whether I am going to be supportive or not supportive.

So I would be very interested in getting some kind of indication on what FERC's analysis of the situation is. Certainly FERC was party to the original agreement. It is the reason we have this plant. FERC issued a special order.

And I would hope that FERC is going to have a position that says they are not going to do in multi-million dollar projects, in this case a multi-billion dollar project, by an inadvertent consequence.

Mr. SCHERMAN. Senator, if I may, as Ms. Court mentioned, this invariably will be raised in the comments filed in the proceeding. I can assure you that the Commission will seriously consider those comments and be sensitive to that matter.

I can also tell you that the Commission over the last several years has been concerned about the relationship between pipelines and their marketing affiliates. A number of Commissioners are concerned about those issues, and if those issues are raised in this proceeding, you can be assured that they will be fairly considered.

Senator CONRAD. I wanted to bring this to your attention because it is obviously a matter of great importance to my state. Frankly, I think it is of significant importance to the Federal government, as the Secretary has indicated.

Thank you.

[The following was submitted for the record at the request of Senator Conrad:]

Department of Energy
Washington, DC 20585

MAY 12 1989

The Honorable Martha O. Hesse
Chairman
Federal Energy Regulatory Commission
Washington, D.C. 20426

Dear Chairman Hesse:

I would like to bring to your attention some concerns of the Department of Energy (the Department) related to the continued operation of the Great Plains Coal Gasification Plant (Plant). These concerns arise in connection with the ongoing Commission proceedings concerning Transcontinental Gas Pipe Line Corporation's (Transco) proposals for a marketing affiliate and a gas inventory charge (FERC Docket Nos. RP88-68 et al. and CP88-391 et al). I request that the Commission consider these concerns carefully before it takes any action on Transco's proposals.

As you are well aware, from its inception, the Great Plains project involved substantially greater risks than an ordinary energy project. In Opinion and Order 119, the Commission provided the regulatory treatment necessary for the successful construction and operation of the plant. In subsequent decisions, the Commission reaffirmed its commitment thereby ensuring that inadvertent government action would not defeat the project. On the private side, four interstate pipelines, including Transco, entered into a "Gas Purchase Agreement" under which, by contract, they committed themselves to purchase the plant's full production. The regulatory and contractual framework for the project recognizes its unique nature and is essential to its continued viability.

For the past ten years, the Department has expended considerable time and expense on the Great Plains project. The plant was financed with $1.5 billion in loans from the Federal Financing Bank, guaranteed by the Department. After the original investors defaulted in 1985, the Department acquired the plant through foreclosure. On October 31, 1988, Dakota Gasification Company (Dakota) purchased the plant from the Department under an Asset Purchase Agreement containing provisions designed to assure continued operation of the plant by establishing a trust account in support of operation and a revenue-sharing plan that would eliminate further U.S. taxpayer subsidy and could return to the government its original investment. For this to occur, the plant must continue to operate for the next 20 years. Both the ability to draw on the trust account and the receipt of revenue sharing payments are, in large part, contingent on the continued validity of the Gas Purchase Agreement. Thus the continued operation of the plant and the integrity of its underlying contracts have a direct economic effect on the U.S. Government.

The Department views the long-term viability of the plant as an important element of our long-term national energy policy. The Great Plains project is a unique undertaking in which a combination of private parties and the U.S. Government cooperated to develop and commercialize the technology for making pipeline-quality synthetic natural gas from coal. The operation of the plant has generated valuable information concerning the use of this "clean coal" technology. This information holds the promise of greatly benefiting the U.S. public by providing a use for our abundant supplies of coal in an environmentally-acceptable manner, while enhancing our national energy security by reducing our dependence on imported oil. The continued operation of the plant, with its concomitant flow of data to the Department, is vital to our retention of this technology in our national energy arsenal.

Recently, Dakota brought to the Department's attention its serious concerns that potential Commission actions concerning Transco's proposals for a marketing affiliate and a gas inventory charge might jeopardize the integrity of the underlying Gas Purchase Agreement and Transco's performance under it. While the Department does not believe indirect Commission action could constitute "force majeure" or otherwise abrogate the gas purchase contract, it urges the Commission to be aware of and take into account the effect on the Great Plains project of any action it might take concerning Transco. Accordingly, the Department requests the Commission to make explicit in any order concerning Transco's proposals that its action is not intended to, and should not be implemented in a manner that could, affect adversely the regulatory and contractual framework on which the Great Plains project is premised.

The Department strongly supports the Commission in its efforts to make the natural gas industry more responsive to the realities of the marketplace. Preservation of the existing regulatory and contractual framework for Great Plains is consistent with these efforts, since the ultimate commercialization of the technology utilized in the project will mean more competition in the future. Gas from coal can be an important element of ensuring American consumers adequate energy supplies at reasonable prices. The Department, therefore, asks the Commission to avoid any inadvertent regulatory disincentive to the continued operation of Great Plains since a truly efficient marketplace has the ability to respond to the realities of today and the future.

Please enter this correspondence in the public record. I appreciate your consideration of the concerns expressed in this letter.

Sincerely,

J. Allen Wampler
Assistant Secretary
Fossil Energy

cc: Commissioner Elizabeth Anne Moler
Commissioner Charles A. Trabandt
Commissioner Charles G. Stalon
Commissioner Jerry J. Langdon

The CHAIRMAN. Senator Bumpers.

STATEMENT OF HON. DALE BUMPERS, U.S. SENATOR FROM ARKANSAS

Senator BUMPERS. Mr. Chairman, let me just say generally that I do not know where I am going to wind up on this legislation. I must say that our rush to deregulate everything has not turned out well in many instances. And that is not to suggest that this bill is not timely.

But I do have a deep and abiding interest in the price and supply of natural gas. If you consider the fact that our oil imports are sitting right on 50 percent—and incidentally, I might say to the Senator from Oklahoma, when we were deregulating oil I remember all the charts about how oil supplies were just going to continue to climb until we became energy independent if we would just decontrol oil prices.

Everybody knows, of course, I think everybody knew at the time, that that was an utter impossibility. You are not going to find oil that God did not make, I do not care what the price is.

At that time OPEC was setting the price, and if they ever get their act together they will set it again. They have had a difficult time with discipline among their membership. But if they ever do establish the discipline, they will set the price.

And of course, gas tracks the price of oil and if gas is deregulated it will follow that. If we are going to deregulate oil, there is really not much argument not to deregulate natural gas. But I just wanted to make that point.

If I were in the gas business, I would want this bill worse than I wanted to go to heaven, and I understand that. And I know the paperwork is very difficult, and I know that sometimes producers take gas that is controlled and they blend it with other gas that is not and so on, and the royalty owners do not always come out well in those deals.

But I wanted to ask you, Mr. Wampler, if you can tell me how much gas right now approximately, if you know, is being sold below the controlled price?

[Pause.]

Mr. WAMPLER. Senator, I do not think we have that number with us. We could certainly furnish it to you.

The CHAIRMAN. Well, it would be 94 percent, would it not? Did you not say six percent was being controlled? So the rest of it is not controlled.

Mr. WAMPLER. Okay, yes, the binding controls would be six percent, so it would be 94.

Senator BUMPERS. So you are saying 94 percent of the gas in this country is selling below the price allowable by FERC under the Natural Gas Policy Act?

Mr. WAMPLER. That is true.

Mr. MALLOY. At or below.

Mr. WAMPLER. At or below.

Senator BUMPERS. At or below.

Mr. MALLOY. It is selling at the ceiling allowed by FERC or below.

Senator **Bumpers**. Well, what I wanted to differentiate between was gas that is selling at the controlled price and the gas that is selling below the controlled price.

Mr. **Malloy**. Forty percent roughly is still subject to some form of price ceiling. Only 6 percent, within that 40 percent, is selling at the ceiling price, so the other 34 percent is selling at below what it could otherwise sell at.

Senator **Bumpers**. So the figure is still the same, only 6 percent of the gas in this country is being sold at the level of the controlled price, is that correct?

Mr. **Malloy**. Correct.

Senator **Metzenbaum**. Could you just repeat that? 40 percent? I did not quite understand. What does the 40 percent mean?

Senator **Bumpers**. 40 percent of it, he said, is at or below the controlled price, and of that amount only—are you talking about 6 percent of the 40 percent or 6 percent of the total gas?

Mr. **Malloy**. No, 6 percent of the total production.

Senator **Bumpers**. Is actually being sold at the controlled price. 94 percent of the gas in this country is being sold below the price that would be allowable under the regulated price under the Natural Gas Policy Act, is that correct?

Mr. **Malloy**. Or is decontrolled.

Senator **Bumpers**. Or is decontrolled.

Mr. **Malloy**. Only 6 percent is controlled.

Senator **Bumpers**. Okay. Now, just assume for the moment, in talking about essentially old gas, that it is controlled, and I guess we are talking essentially about old gas, are we not, that is selling at the controlled price?

Mr. **Malloy**. Correct.

Senator **Bumpers**. Is there any way that that gas under existing FERC regulations and the NGPA, that this controlled gas can lose its identity and effectively be decontrolled? In other words, let me give you an illustration. If I have—say I am a pipeline company or a local distribution company with several subsidiaries, including an exploration company.

I have production that, for example, where the price is controlled at—what is the lowest controlled price of gas today?

Mr. **Malloy**. There is a minimal amount of gas that is at under a dollar.

Senator **Bumpers**. Well, let us just take a dollar. Let us assume that it is controlled at a dollar an MCF. And let us assume that I take that gas and I sell it to a stranger, who in turn sells it to a stranger, who in turn sells it back to a subsidiary of the original seller, who then sells it to the seller for $2.50.

Is that permissible?

Mr. **Wampler**. Let me, Senator, ask FERC to answer that. They do have auditing procedures and they could explain those.

Senator **Bumpers**. Did you understand the question?

Ms. **Court**. Yes, sir. The maximum lawful price would obtain throughout the transactions that you have just described, because they would all be first sales.

Senator **Bumpers**. So anybody who did that would be perpetrating a fraud and a violation of the law?

Ms. **Court**. It would be a violation of the maximum lawful price set by Congress in Title I.

Senator **Bumpers**. Okay. Now, let me ask you a series of unrelated questions dealing with something that I can tell you I am not going to support this bill unless I get this redressed, and it is a local situation for me. I do not know whether it exists in the rest of the country or not.

But in the 1940's and 1950's, lessors came into western Arkansas and eastern Oklahoma, before gas was ever really found in substantial quantities there, and they took leases from the farmers there, all of whom were poor and most of whom saw "one-eighth" in the lease about 25 or 30 times, and they got a dollar an acre bonus bid and they thought they had found a pot at the end of the rainbow. They could not sign fast enough.

Then they started reading the lease and they saw that where natural gas was concerned, because these leases included condensates and oil and everything else, but in the paragraph that covered natural gas, the royalties, it said "said lessor shall receive one-eighth of the value of the gas, said value to be calculated at the rate of five cents per MCF."

Hundreds and hundreds of leases were taken like that. And then some of the biggest gas fields found in the country were found there—the Cecil Field, the Aetna Field, the Ursula Field.

Those people in Arkansas have been subjected to these fixed price royalties, some of them for as long as 45 years. And they have been getting—some of the companies were generous enough to raise the royalty to one-eighth of seven cents and then to 14 cents and so on. And in all fairness, natural gas was selling then for 16 cents an MCF.

Millions and millions of dollars of royalties should have gone to those poor people, who did not have the foggiest idea what they were signing, but they have never received them and they will never, and a lot of those wells are playing out and the fields are playing out. And so this is very late, my effort is very late in redressing what is one of the most serious injustices ever to occur in my state.

Now, my point is this. Do you have any objection, Mr. Wampler or Mister—is it Mr. Scherman? Do you have any objection to an amendment which would state that the day this thing goes into effect that those contracts would be subject to renegotiation?

Do you think it is fair, for example, for a person to be getting $2.50 an MCF for gas and paying the royalty owner on the basis of 16 cents?

Mr. **Wampler**. Senator, I certainly sympathize with those people that entered into contracts like that. I think that—and I seriously do not want to appear callous to their plight, but I think——

Senator **Bumpers**. But you are about to. [Laughter.]

Mr. **Wampler**. I think that the Department of Energy especially has to look at this from the perspective of energy security, and, I think, from the perspective of energy security and the perspective of the consumer in general, that it just makes sense to do it. And again, I do sympathize with them.

But I think that there are many, many issues out there that are very individual and could be addressed in a bill like this. But I think if we begin doing that and we look at our past history, we will develop a bill that certainly cannot get through Congress.

That is why the Administration has advocated a clean bill from the very beginning and does support the consensus, without items being added to it that do not have to be. I can sympathize.

Senator BUMPERS. Does it offend your sense of justice or propriety or any other sense you might have, Mr. Wampler, for a royalty owner to be getting two cents an MCF while the driller who has had that well for as long as 30, 40 years is getting $2.50 for it?

Mr. WAMPLER. Oh, certainly. If I was a landowner and a royalty holder on that, it would certainly offend me. I think, though, again I do not want to defend the situation at all, but those were contracts that I assume were entered into freely at the time, that looked pretty good at the time. And as you pointed out, they got a pretty good share at the beginning.

Senator BUMPERS. It did not even look good at the time. Gas was selling for 16 cents at the time the contract was signed, and they were getting one-eighth of four cents, not 16 cents.

Mr. WAMPLER. Well again, Senator, I do sympathize with them, I truly do.

Senator BUMPERS. Mr. Chairman, I do not know of any place else in the country—I may be wrong, but I do not know of any place else in the country where this happened to honest, well-intentioned people—and they did not realize until after gas was discovered and somebody pointed out to them that they were not going to get an eighth of the value of the gas at the mouth of the well.

The CHAIRMAN. I think that is not part of the NGPA. I think that is——

Senator BUMPERS. It is not.

The CHAIRMAN [continuing]. Subject to state jurisdiction.

Who was the Governor of Arkansas back during those days? [Laughter.]

Senator BUMPERS. Jefferson Davis. [Laughter.]

But anyway, Mr. Chairman, this is not a part of the Natural Gas Policy Act and it is not a part of the real problem we are addressing here. But I can tell you one thing. What you are going to do here by decontrolling price—I mean, everybody knows that gas prices are probably going to go up, if not now, some time in the future, because we are still using more gas in this country. Is this not correct, Mr. Wampler?

Mr. WAMPLER. We are.

Senator BUMPERS. We are using considerably more gas in this country every year than we are producing. And if that is not a prescription for higher prices, then I do not know anything about the free market system.

I am just saying that this is the first opportunity I have really had to air this and redress the problem, and I intend to do everything I can. And in all fairness, Mr. Chairman—this is not a threat—I do not want the bill to leave here until that is taken care of.

The CHAIRMAN. Well, between 1982 and 1985 the price of natural gas went down by 32 percent under a decontrol scheme. So I hope that tells you what decontrol can do.

Our final Senator, Senator Ford.

Senator **Ford**. I wanted to give my time to the eloquent Senator from Arkansas. He is very concerned about this. And this is, I think, a specific problem.

I might say to him that we had that in the broad form deed as it related to surface mining, that the deeds were written back in 1870, 1880, 1890, and so forth, and the courts upheld it forever.

Then we passed a constitutional amendment. I do not know whether that will help you or not, but it carried by about 72, 74 percent. And that might eliminate some of your problem.

Mr. Chairman, I will not take any of your time. Mr. Scherman's and Mr. Wampler's reputations have already been laid on the line, and I think you ought to put a little caveat on, that natural gas will be based on the price of oil and that oil is continuing to go up, and we are being squeezed and squeezed and squeezed by imported oil. And as long as they continue to squeeze us, that is the best thing ever to happen to natural gas.

If this bill does fall apart, Mr. Chairman, under the present circumstances I will join others in keeping it in the Committee.

The **Chairman**. Thank you, Senator Ford.

Thank you very much, gentlemen. I might add, with some apologies to our next witnesses, we have nine witnesses to deal with and about an hour. At least I have an hour. There may be other Senators who can stay. So that means about five minutes per witness, with no questions.

So our next panel will be: Mr. Nick Bush, President of the Natural Gas Supply Association; Danny Conklin, who is Chairman of IPAA; Ken Lay, who is Chairman and Chief Executive Officer of Enron and who is also Chairman of the Board of INGAA; and Mr. Charles Schusterman, who is Chairman of the Board of Samson Companies of Tulsa, Oklahoma.

Gentlemen, we have got a five minute light here, and I ask you to please summarize. I think you can see the chief concerns of the Senate, and if you would please summarize and hit those highlights within five minutes.

Let us begin with Nick Bush.

STATEMENT OF NICHOLAS J. BUSH, PRESIDENT, NATURAL GAS SUPPLY ASSOCIATION

Mr. **Bush**. Good morning, Mr. Chairman, Senator Domenici, and members of the Committee.

My name is Nicholas J. Bush and I am President of the Natural Gas Supply Association, a national organization that represents independent and integrated domestic companies that explore for, develop, and market considerably more than half of the nation's natural gas supply.

We appreciate the opportunity, Mr. Chairman, to appear before the Committee again to advocate the total deregulation of natural gas at the wellhead. I would also like to express our gratitude to you, to Senator Domenici, to Senator Ford and Senator Nickles for the leadership you have all shown on the natural gas policy issue over the years.

Mr. Chairman, there is overwhelming evidence and experience that competition at the wellhead is strong and that consumers, the industry, indeed the nation, are disadvantaged by the needless continuation of remaining controls on natural gas.

Mr. Chairman, much of the attention on these initiatives focused late last fall and early this year on Congressman Sharp's draft legislation. About the only contentious issue in consideration before the House was the effective date for total deregulation.

Senators Ford and Nickles, with the introduction of S. 625, which proposed an effective date of January 1, 1993, were instrumental in providing the momentum for a compromise acceptable to virtually all.

NGSA would have preferred that the effective date be the date of enactment and, while we do not agree with the arguments made in support of the delay, we do agree that the most important thing was to achieve a workable consensus, a political consensus in support of a deregulation bill. And since the 1/1/83 date did that, we support that compromise.

The major and perhaps only significant difference among S. 783, S. 625, and H.R. 1722 is the inclusion in the House bill of a provision that allows for natural gas produced from a newly spudded well to be decontrolled as of the first date after enactment of the statute.

The newly spudded well provision is apparently controversial, particularly among some producers. Again, NGSA does not necessarily agree with many of the contentions that are being made by those who would drop this provision. In particular, it has been suggested that somehow this provision may inadvertently negate the tax credits for production of Devonian shale, coal bed methane gas, and tight sands gas.

Mr. Chairman, it is our assessment that this legislation has no impact whatsoever on the tax credits for coal bed methane gas or Devonian shale, since neither are required to be regulated in order to qualify for the applicable tax credit.

In the case of tight sands gas, while this bill may have impact, it is generally thought and it is the consensus of most opinion that the Supreme Court's decision in March 1988 upholding FERC's 406 decision already has decided the question of deregulating new tight sands wells, many new tight sands wells.

Frankly, however, the amount of gas at issue here is so insignificant that if what we are seeking is a national energy policy that really increases the efficiency of the national natural gas industry, then we think it is of little significance as to how you resolve it. Keep it, drop it, amend it, we are willing to support whatever provision you decide to come up with in terms of a resolution.

Focusing the debate, however, on this disagreement, much the same as trying to focus in on a short-lived dispute over the effective date, we think threatens to obscure two important facts: First, that the legislation has achieved a consensus for total deregulation, winning support from some who have consistently opposed it;

And secondly and perhaps most important, enactment of any one of these bills will mean immediate and long-term benefits for natural gas consumers and the natural gas industry.

While the amount of natural gas under controls has diminished considerably since this debate began many years ago and the Congress and the Federal Energy Regulatory Commission have in the meantime taken steps to increase the competitiveness of natural gas and energy markets, these bills are still timely and important legislation.

Mr. Chairman, removing the remaining controls on natural gas at the wellhead will enhance the nation's energy security, reduce imports of foreign oil, rationalize gas pricing and investment decisions, and be beneficial to the nation's environment, and do so with significant advantages for consumers.

With regard to the consumer argument, let me just highlight one important fact. Since the partial deregulation of the Natural Gas Policy Act took place in 1985, natural gas prices to consumers have fallen nearly $60 billion, and producers have absorbed virtually all of those $60 billion in lower revenues.

Despite predictions heard before this Committee and in the House of Representatives about potential calamity absent some kind of Federal intrusion into contracts, the industry has resolved virtually all of its take-or-pay problems. And again, that has been done with producers recovering a very small fraction of the liabilities that were owed to them under those contracts.

Given these facts, we think there is some empathy perhaps with the producers who fear or have some apprehension about the decontrol. But regardless of producers' concerns or any particular regional concern, what we are trying to bring to bear here is a national natural gas industry that can work efficiently.

And to that end, Mr. Chairman, we would urge you to get on with passage of this bill, to put this issue behind us and let us work together to expand natural gas sales.

Thank you.

[The prepared statement of Mr. Bush follows:]

NATURAL GAS DECONTROL LEGISLATION:

GAS PRODUCERS' PERSPECTIVE

TESTIMONY

OF

NICHOLAS J. BUSH

PRESIDENT

NATURAL GAS SUPPLY ASSOCIATION

(NGSA)

BEFORE THE

SENATE ENERGY & NATURAL RESOURCES COMMITTEE

MAY 8, 1989

NOTE: This written testimony is identical to that submitted to the Subcommittee on Energy & Power of the House Energy and Commerce Committee on April 5, 1989

SUMMARY OF TESTIMONY OF THE NATURAL GAS SUPPLY ASSOCIATION

- NGSA participates actively in advocating comprehensive, market-oriented solutions to inequities and distortions that have been created by past legislative and regulatory decisions.
- NGSA believes that a deregulated natural gas wellhead market will most efficiently match future gas supplies with demand at reasonable prices to consumers.
- NGSA advocates straight-forward single issue decontrol legislation.
- NGSA supports the 1/1/93 date as a "not later than" date for decontrol for purposes of achieving a compromise.
- Since the 1980's the natural gas industry has gone through a major transition due, in part, to Order 436/500.
- An estimated 25 to 30 percent of gas produced annually in the United States is still under NGPA price controls.
- The NGPA produces undesirable effects such as pricing significant quantities of old gas below market, which has discouraged further investment from previously-discovered reservoirs. Below market pricing of old gas has encouraged the purchase of additional supplies of unregulated gas at above market clearing levels.
- Regulation of the natural gas market also creates irrational economic incentives.
- A fundamental flaw of the NGPA is that it was enacted due to a perceived supply problems. Unfortunately those supply problems did not exist when the NGPA was enacted.
- The NGPA demonstrates the difficulty of attempting to draft statutory responses to perceived future gas market conditions.
- The effects of partial deregulation in 1985 suggest that there will be no aggregate price fly-up.
- NGSA believes that given the natural gas market today that an increase in the price of gas due to certain contract clauses is highly unlikely.
- NGSA also contends that wellhead decontrol will not exacerbate take-or-pay problems due to the likelihood that renegotiation of contracts will take place as it did upon partial decontrol in 1985.

Mr. Chairman and Members of the Subcommittee, I am Nicholas J. Bush, President of the Natural Gas Supply Association (NGSA). NGSA is a national organization of independent and integrated domestic companies which explore for, develop, produce and market approximately 90% of the nation's natural gas.

On behalf of our member companies, NGSA thanks the Chairman and his staff for the opportunity to participate in today's hearing. I would like to commend Congressman Sharp for his outstanding job in fashioning the legislation that has won the support of 29 members of Congress including House Energy and Commerce Committee Chairman John Dingell and the Committee's Ranking Minority member, Congressman Norman Lent.

My written testimony will basically discuss NGSA's position on natural gas decontrol. In the next section, I identify why natural gas decontrol is appropriate and the problems that the Natural Gas Policy Act of 1978 (NGPA) have caused the industry. Following that section, I describe criticisms that other parties commonly offer when decontrol legislation is proposed and NGSA's response to those criticisms. Finally, in the last section entitled conclusion, I identify the lessons embedded in the 35 years of Federal controls at the wellhead. We encourage the Subcommittee's thorough review of H.R. 1595 and support its passage at the earliest possible date.

NGSA Position

During the past several years, the Congress and others in the public sector as well as many in the private sector have debated the wisdom of the nation's natural gas policy. NGSA has participated actively in those discussions, advocating comprehensive, market-oriented solutions to what our membership believes are the gas market inequities and distortions that have been created by past legislative and regulatory decisions. We have consistently urged and advocated the total decontrol of natural gas at the wellhead. We believe that a free natural gas wellhead market will most efficiently match future gas supplies with demand at reasonable prices to consumers. In addition to being a pro-consumer initiative, NGSA contends that decontrol will have long-term benefits for the natural gas industry and the consumers it serves.

There is certainly Congressional precedent in recent times for agreement to seek passage of a clean, unencumbered decontrol bill. For example, when others in the natural gas industry urged that repeal of the Fuel Use Act be given priority and be considered without amendments, like mandatory contract carriage, the proponents of such issues agreed. NGSA remains confident that in a similar fashion, a straight-forward single issue decontrol proposal will be allowed to proceed on its own merits.

A minor debate that accompanied agreement on natural gas decontrol legislation is when such legislation should become effective. NGSA believes decontrol legislation effective upon enactment to be most beneficial. However, other Associations supported total decontrol in five years. Since that time, both H.R. 1595 and the measure introduced by Senators Ford and Nickles have advocated January 1, 1993. NGSA will support the 1/1/93 date as a "not later than" date for purposes of achieving a political compromise. However, NGSA does not support the analyses offered for a latter date.

Changes in Natural Gas Industry

Since the 1980's, the natural gas industry has gone through a major transition due, in part, to the issuance of Orders 436/500 at the Federal Energy Regulatory Commission (FERC). Orders 436/500, among other things, gives pipeline customers the option to buy gas under gas sales contracts with their traditional suppliers (i.e., interstate pipelines), or from other pipelines, directly from producers, independent marketers, or through the spot market. The FERC has encouraged pipelines to transport the gas bought from others and Orders 436/500 require that gas be transported in a non-discriminatory manner. As a consequence, the natural gas industry's traditional structure has been dramatically altered since the days prior to 1980 which were marked by pipeline sales monopolies. This alteration has allowed buyers to choose among multiple suppliers in their search for natural gas.

Another change in the industry from the early 1980's is the scrutiny currently given to interstate pipeline passthrough. Passthrough allows interstate pipelines to recover their costs and to earn reasonable returns. Traditionally, passthrough guarantees were never questioned. However, recent policies adopted at the FERC and at the state level (i.e., least cost purchasing policies) have helped assure that consumers pay low gas costs. These policies, coupled with other industry changes, have led to a decrease in average residential prices for natural gas by about $0.85 from the winter of 1984-1985 to the winter of 1987-1988.

Competition among gas, oil, and coal has increased. Due, in part, to the oil price collapse of 1986, many industrials made a calculated business decision not to rely solely on one source of energy. Indeed, today many industrials are dual fueled and can either burn oil, gas, or coal. This has resulted in intensified inter-fuel competition and thereby ensures consumers with low energy costs.

Other examples of change to the natural gas industry which benefit consumers could be mentioned. Suffice it to say, natural gas supply is driven more by market forces and pervasive competition than it ever has in the past.

Current Gas Policy

Since 1978, natural gas pricing policy has been set by the Natural Gas Policy Act (NGPA).[1] The NGPA provided for deregulation of producers in an extremely complicated and gradual process. About one-half of the nation's gas supply was scheduled for deregulation in three steps - 1979, 1985 and 1987. The remaining half was never scheduled for deregulation, but would diminish over time as a consequence of depletion of old reserves until some time well into the twenty-first century, when no regulated gas would continue to flow in the market.

The prices of twenty-four categories of natural gas are currently controlled by the NGPA. These categories of natural gas are based upon varying circumstances, often involving the time and place of production. According to EIA, controlled natural gas prices range from 35 cents per million Btus (minimum rate gas) to $6.72 per million Btus (gas produced from tight sands).

An estimated 25 to 30 percent of gas produced annually in the United States is still under NGPA price controls (1987 natural gas production was 16.1 Tcf). Two basic types of natural gas are involved. One is so-called "old" gas (Section 104) and the other is new production of forever-regulated gas which was intended to be price-controlled until production from the reservoir is exhausted. Generally, old gas is produced from fields subject to Natural Gas Act (NGA) regulation before the NGPA was passed. "Forever-regulated" gas is produced under other circumstances which Congress felt required price regulation. Congress also sought to create disincentives in the NGPA for industrial customers to use natural gas. For example, the incremental pricing provisions of the NGPA forced pipelines and distributors to charge higher prices to industrial consumers.[2] Furthermore, in a companion statute, the Powerplant and Industrial Fuel Use Act of 1978 (PIFUA)[3], prohibited completely the use of gas in numerous industrial and electric utility companies. As will be discussed later, these provisions caused perceived supply distortions which had undesirable effects on the natural gas market.

The Undesirable Effects of the NGPA

Supporters of the NGPA believed that, in spite of its obvious complexity, such fine-tuning of gas prices could stimulate new gas supplies at less cost than market-based pricing systems. Experience under the NGPA, however, demonstrates that it is not working. Pricing significant quantities of old natural gas below market has discouraged further investment from previously-discovered reservoirs, from which more gas would be produced at relatively lower cost for consumers. Equally important, below market pricing of old gas has encouraged the purchase of additional supplies of unregulated natural gas at above market-clearing levels.

NGPA Encouraged the Purchase of Expensive Gas

Aside from pricing old gas below market, regulation of the domestic gas market creates irrational economic incentives. Pricing significant quantities of natural gas below market encourages the purchase of new supplies at prices higher than market clearing levels. To the extent that a pipeline has a large inventory of low priced regulated gas (e.g., a large gas cushion), a pipeline can purchase basically uneconomic high cost supply increments such as LNG, synthetic gas, imported gas, and high-priced decontrolled gas because price regulation under the NGPA affords the opportunity to roll-in high cost gas supplies with low cost regulated supplies. Even in a widely recognized atmosphere of excess gas deliverability, and the availability of lower cost domestic supplies, some pipelines with a large cushion continue to purchase above market foreign gas reflecting the fact that the NGPA continues to provide pipelines with erroneous signals which distort market realities. Consumers do not benefit when natural gas prices are kept artificially low by the NGPA when the benefit of low regulated prices merely allows a pipeline to roll-in high cost supplies.

The Phillips decision, decided by the Supreme Court in 1954, extended government intervention into the wellhead sales market for gas when the problems existed only in the transportation market. Similarly, pervasive government intervention into the wellhead sales market was again attempted in the NGPA to address perceived market imperfections.

Fundamental Shortcomings of the NGPA

One of the main goals of the NGPA was to eliminate gas shortage that appeared in the winter of 1976-1977. By 1978, the year the NGPA was enacted, it was still thought that a fundamental shortage of natural gas existed. We know now, however, that the shortage that existed in 1978 was created by below-market pricing regulations. Indeed, after the passage of the NGPA, the Secretary of Energy Schlesinger stated that a gas surplus of one trillion cubic feet existed.[4] The surplus existing at that time was exacerbated by the limits on industrial and electric utility use of gas in the incremental pricing provisions of the NGPA and in the PIFUA.

Another flaw of the NGPA was its use of ceiling prices to forecast market prices. For example, the NGPA states that the price for "new gas" would increase at the rate of inflation plus four percent a year. The rationale for that provision was the expectation that the "new gas" ceiling price would approximate the market price for that gas at all times. As of July 1987, however, the "new gas" ceiling price was twice the market price of gas.[5] This demonstrates the difficulty of attempting to draft statutory responses to future natural gas market conditions.

Claims Concerning Decontrol of Natural Gas

A few organizations have predicted that decontrol of Title I of the NGPA would result in price "fly-ups" and financial disaster for interstate pipelines. These same, dubious claims of imminent price fly-up were made by partial decontrol opponents in 1984. The American Gas Association (AGA) predicted at one point that gas prices would increase 39% after 1/1/85 if the NGPA were allowed to run its course.[6] Similarly, the Citizens/Labor Energy Coalition (C/LEC) predicted an increase of 58% around the same time.[7] Somewhat later, the Interstate Natural Gas Association of America (INGAA) predicted price increases on the magnitude of 9 - 12 percent.[8] To illustrate the difference between the unfounded claims and what really happened, NGSA has included an attachment to this written testimony. The attachment gives a point-by-point refutation of claims and issues raised by the Citizen/Labor Energy Coalition about what would occur under partial decontrol on January 1, 1985 and total decontrol in 1989. (See attachments 1 and 2.)

NGSA maintained through that same time period and since that producers and pipelines would work toward renegotiated solutions of whatever problems may exist within their contractual relationships. We also were confident that there would not be a rapid price increase as a result of either the partial deregulation called for by the NGPA or complete deregulation. Both assertions have been borne out since partial decontrol in 1985.

In fact, the effects of partial deregulation in 1985 strongly suggest that there will be no aggregate price fly-up. Prior to partial decontrol on January 1, 1985, the average 1984 natural gas price, as reported by the EIA, was $2.66/Mcf. After partial decontrol, the average natural gas price for 1985 declined to $2.51/Mcf and has dropped steadily since to the 1987 average wellhead price of $1.67/Mcf.[9]

Thus the experience from partial decontrol in 1985 strongly suggests that there will be no aggregate price fly-up because the current gas market will not allow it. As previously noted, only 25% of the nation's gas remains under controls, an amount substantially less than that controlled in 1984 prior to partial deregulation.

Another common claim concerning the effects of decontrol is that certain contract clauses will lead to a price increase. NGSA believes that given the natural gas market as it exists today, an increase is highly unlikely. There are two reasons why claim is invalid. They are the same reasons no fly-up occurred in 1985.

First, natural gas prices must compete with other fuels. Gas prices have declined since partial decontrol because competing fuel prices, such as residual oil prices, are lower than natural gas prices in some markets and there was a surplus of natural gas available for sale. The decline in prices proves that market conditions and not contract clauses will determine the price of natural gas in a decontrolled, competitive market.

Second, natural gas supplies continue to exceed demand. According to the EIA, during 1988, the surplus of natural gas available for sale averaged 1,625 Tcf or 9.0% of consumption (18 Tcf). Consequently, NGSA believes that claims of a fly-up are invalid.

Finally, a few interstate pipelines claim that wellhead decontrol would exacerbate take-or-pay problems. NGSA does not agree with that position.

We believe that renegotiation will take place upon decontrol as it did upon partial decontrol in 1985. Indeed, renegotiation of contracts has been occurring since 1982.[10] As a result, prices paid for natural gas at the wellhead have dropped 99 cents/Mcf. According to the pipelines' own Interstate Natural Gas Association of America, these negotiations have eliminated a total of $20 billion in take-or-pay liabilities through year-end 1987 at a cost of $3.4 billion, or 10 to 20 cents on the dollar. The liability faced by the pipelines has thus been reduced by 80 to 90 percent. It should be noted that the pipelines may not pass through all of these costs to the ultimate consumer. As illustrated in Attachment 3, pipelines are passing through about 60 percent of the settlement costs to their local gas distributors. Thus, out of $3.4 billion in total pipeline settlement costs, only about $2.0 billion is being passed on to local gas utilities. If the local gas utilities amortized these costs to their customers over 5 years, then the average cost to the utility consumers is expected to amount to 4.4 cents/Mcf. This 4.4 cents/Mcf consumer cost should be compared to the 99 cents/Mcf wellhead gas price reduction that occurred from 1984 through 1987. Even if the final take-or-pay settlement costs were to double, the benefits of natural gas decontrol to gas consumers would still be about 10 times greater than the take-or-pay costs passed through to gas consumers.

The gas industry has thus demonstrated its readiness to deal with changes in the market environment and to renegotiate contracts, if necessary, to maintain markets. In addition, a NGSA survey on take-or-pay completed in 1988 found continuing improvement in take-or-pay resolution rates. The 1986 NGSA survey reported a 59 percent cumulative resolution rate which increased to 71 percent and 84 percent resolution rates for 1987 and 1988. Preliminary results suggest that 93% percent was resolved by year-end 1988. These figures indicate that the take-or-pay situation is close to final resolution.

Interstate pipelines have not declared bankruptcy in the process of renegotiating three-fourths of their contracts, nor are they likely to do so in the future in renegotiating contracts for less than one-fourth the remaining controlled production.

Thus, if deregulation occurs, market forces, which actually determine prices, will also trigger any needed contract renegotiation to maintain customer sales.

Conclusion

NGSA concludes that the experience of the last four years forcefully demonstrates consumers will be best served by the complete deregulation of natural gas at the wellhead (see attachment 4). In particular, decontrol will ensure a more plentiful supply of less expensive gas being made available to the market. Market-oriented solutions and not pervasive regulatory schemes will significantly benefit consumers, the gas industry, and the nation as well.

Footnotes

[1] Natural Gas Policy Act of 1978, Pub. L. No. 95-621, 92 Stat. 3351 (Codified at 15 U.S.C. Section 3301-3432 (1982)).

[2] 15 U.S.C. Subsection 3341-3348 (1982).

[3] PIFUA, Pub. L. No. 95-620, 92 Stat. 3289 (1979).

[4] 1978 Energy Users Report (BNA) 6 (November 16, 1978).

[5] Compare Section 271.101 Ceiling Prices for Certain Categories of Natural Gas II FERC Stats. & Regs. Para 24,111 at 14158 with, Survey of Domestic: Spot Market Prices 15 Energy Rep. (BNA) 568 (1987).

[6] Winter 1983 AGA-TERA Base Case, February 8, 1983, p. 2.

[7] "Gas Prices Out of Control: The Cost of Inaction" Citizens Labor Energy Coalition Study, February 1983.

[8] "Analysis of Price Fly-up Under the Natural Gas Policy Act", Interstate Natural Gas Association of America, April 1984.

[9] As of this writing, the EIA has not reported all of 1988's gas wellhead prices. 1988 prices reported to date are estimates.

[10] In a report prepared for NGSA by Foster Associates, Inc., it was revealed that the total expected relief granted by producers during 1984 was estimated at $3.2 billion, or about one-third of the total cumulative take-or-pay obligations. See Foster Associates, "Analysis of the Take-or-Pay Problem", March 1984.

The CHAIRMAN. Thank you very much, Mr. Bush.
Danny Conklin.

STATEMENT OF DANNY CONKLIN, CHAIRMAN, INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

Mr. CONKLIN. My name is Danny Conklin, a partner in Philcon Development Company of Amarillo, Texas, an oil and natural gas exploration company; and I appear here today as Chairman of the Independent Petroleum Association of America.

Mr. Chairman, it is indeed a pleasure for me to be here today supporting legislation that will finally put an end to 35 years of wellhead controls on the price of natural gas. The fact that the House, in the past reluctant to even consider decontrol, has acted affirmatively is a landmark event and should be viewed as an incentive for the Senate to follow suit in a timely manner,

I hope when you get a minute you will look at the charts attached to our written testimony. They make it clear in terms of revenue losses that we producers have already, shall I say, given at the office. When one notes a 40 percent drop in five years in wellhead revenues for natural gas, it is significant that we are doing well as we are.

But as the second chart shows, drilling for new supplies is lagging, and I would hope that the decontrol will signal the supply side and will put us back to work.

While I know taxes is the responsibility of another Committee, I do want to recognize and thank a number of members of this Committee for co-sponsoring S. 234 and S. 449, two bills designed to make changes in our tax structure which would help in attracting new revenues to the drilling industry. They, like final decontrol of natural gas, are elements of a much-needed national energy policy.

In conclusion, Mr. Chairman, no matter how long we work at this legislative process, it will be impossible to come up with a perfect bill. We know some producers and some users would have liked to see the bill deregulate remaining controlled natural gas immediately. There are others who probably believe we should never decontrol.

A number of producers would like to see language which would mandate total pipeline rate reform as well as open access carriage, and there is a need for legislation in both of these areas. But we are also aware that there are those who want to prohibit the FERC from permitting distribution companies bypass, a move producers oppose.

Likewise, we hear of others who still would like to see a legislative take-or-pay fix, another move we would oppose. Another issue which has received a flurry of attention recently has been the so-called spud date issue. From the standpoint of a number of independents, S. 783, which is mute on this issue, would be preferable to the House-passed bill. However, I have talked to a number of those who have sought to modify the House bill and, while they are strong in their support for change, they do not want to see this issue kill the process.

The overall objective of final decontrol is of paramount importance. Therefore, again we commend you for your efforts and urge the Committee to move quickly to resolve any differences and to pass legislation which can be approved by the full Senate and sent to the President.

Thank you for your consideration. It is a pleasure for me to be here today.

[The prepared statement of Mr. Conklin follows:]

INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA

STATEMENT OF
DANNY CONKLIN
Representing the
INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA
AND

AMERICAN ASSOCIATION OF PETROLEUM LANDMEN
ASSOCIATION OF OILWELL SERVICING CONTRACTORS
CALIFORNIA INDEPENDENT PRODUCERS ASSOCIATION
COASTAL OIL AND GAS ASSOCIATION
EASTERN KANSAS OIL AND GAS ASSOCIATION, INC.
EAST TEXAS PRODUCERS AND ROYALTY OWNERS ASSOCIATION
ENERGY CONSUMERS AND PRODUCERS ASSOCIATION
GEORGIA OIL AND GAS ASSOCIATION
ILLINOIS OIL AND GAS ASSOCIATION
INDEPENDENT OIL AND GAS ASSOCIATION OF NEW YORK
INDEPENDENT OIL AND GAS ASSOCIATION OF WEST VIRGINIA
INDEPENDENT OIL PRODUCERS' AGENCY
INDEPENDENT OIL PRODUCERS ASSOCIATION TRI-STATE, INC.
INDEPENDENT PETROLEUM ASSOCIATION OF MOUNTAIN STATES
INDEPENDENT PETROLEUM ASSOCIATION OF NEW MEXICO
INDIANA OIL AND GAS ASSOCIATION
INTERNATIONAL ASSOCIATION OF DESK AND DERRICK CLUBS
INTERNATIONAL ASSOCIATION OF GEOPHYSICAL CONTRACTORS
KANSAS INDEPENDENT OIL AND GAS ASSOCIATION
KENTUCKY OIL AND GAS ASSOCIATION
LIAISON COMMITTEE OF COOPERATING OIL AND GAS ASSOCIATIONS
LOUISIANA ASSOCIATION OF INDEPENDENT PRODUCERS AND ROYALTY OWNERS
LOUISIANA LANDOWNERS ASSOCIATIONS, INC.
MICHIGAN OIL AND GAS ASSOCIATION
NATIONAL STRIPPER WELL ASSOCIATION
NEW MEXICO OIL AND GAS ASSOCIATION
NEW YORK STATE OIL PRODUCERS ASSOCIATION
NORTH TEXAS OIL AND GAS ASSOCIATION
OHIO OIL AND GAS ASSOCIATION
OHIO PETROLEUM PRODUCERS ASSOCIATION
OIL INVESTMENT INSTITUTE
OKLAHOMA INDEPENDENT PETROLEUM ASSOCIATION
ORANGE COUNTY PETROLEUM ASSOCIATION
PANHANDLE PRODUCERS AND ROYALTY OWNERS ASSOCIATION
PENNSYLVANIA GRADE CRUDE OIL ASSOCIATION
PENNSYLVANIA NATURAL GAS ASSOCIATES
PENNSYLVANIA OIL AND GAS ASSOCIATION
PERMIAN BASIN PETROLEUM ASSOCIATION
ROCKY MOUNTAIN OIL AND GAS ASSOCIATION
ROYALTY OWNERS AND INDEPENDENT OIL AND GAS PRODUCERS ASSOCIATION OF ARKANSAS
TENNESSEE OIL AND GAS ASSOCIATION
VIRGINIA OIL AND GAS ASSOCIATION
WEST CENTRAL TEXAS OIL AND GAS ASSOCIATION

Before the
Senate Energy and Natural Resources Committee
May 8, 1989
Testimony in support of legislation
ending wellhead controls on the price of natural gas.

Representing America's Domestic Petroleum Explorer/Producers
For information call (202) 857-4722

Statement of
the
Independent Petroleum Association of America
before the
Senate Energy and Natural Resources Committee
May 8, 1989

My name is Danny Conklin, a partner in Philcon Development of Amarillo, Texas, an oil and natural gas exploration company. I appear here today as Chairman of the Independent Petroleum Association of America, the national association representing the nearly 10,000 independent crude oil and natural gas producer/explorers in all 33 states with oil and natural gas production.

Mr. Chairman, it is indeed a pleasure for me to be here today supporting legislation that will finally put an end to 35 years of wellhead controls on the price of natural gas.

The fact that the House, in the past reluctant to even consider decontrol, has acted affirmatively is a landmark event and should be viewed as an incentive for the Senate to follow suit in a timely manner.

In fact, Mr. Chairman, we have suggested to a number of you and to Administration officials that we should work toward a White House bill signing ceremony on June 7 -- the 35th Anniversary of the Supreme Court decision which first extended federal controls to the wellhead.

Having already taken part in the House hearings and action, it is hard for me, a veteran of the gas battles of 1978 and 1983, to believe the level of agreement on this legislation -- but I realize there are some consumer interests who still oppose this bill. They still think that we producers somehow stand to gain a windfall.

In all honesty, I hope producers will see some gain in wellhead revenues, but certainly that would not be a windfall.

Let me direct your attention to Chart 1. All of you were treated to many headlines about the OPEC-forced drop in oil prices beginning in 1986. As the chart shows, total value at the wellhead of U.S. crude oil has dropped from $99.4 billion in 1981, to less than $37.7 billion last year. As I say, everyone knows about the crude oil drop -- though I doubt that they realize it has been so severe. A two-thirds decline in any industry in seven years is severe!

But not so broadly publicized is what has happened to natural gas revenues at the wellhead during this same period. Also shown on Chart 1, natural gas revenues have dropped from a high of $48.5 billion to $30.6 billion during the same period. While not as steep as the drop in crude oil, again it is severe, and would have shadowed oil but for two things. First, due to existing price controls at the wellhead in the early 1980's, natural gas revenues never reached the equivalent peak price level of oil. Secondly, revenues have leveled out in 1987 and 1988 due to increased demand, not because of increased prices.

And the 70 percent drop in crude oil revenue and the 40 percent drop in natural gas, came while the Consumer Price Index increased by more than 20 percent.

I know you are not interested in wellhead revenues just for the sake of revenues. What do those revenues do, we can ask? That answer comes most dramatically in Chart 2 which reflects levels of drilling rig activity over the past five years. As you can see, with minor exception, this year's level of drilling consistently has been below the record-low levels of 1987. While there are some indications that may see an increase in drilling later this year. Let me caution, that we should be aware of a couple of things.

First, it will take much more than modest increases in drilling activity to meet the long-term needs of U.S. energy users. Secondly, the expected stirring of activity is the result of improved crude oil prices, not because of adequate natural gas price levels.

In fact, current natural gas spot prices -- prices available to most new wells drilled -- are at their lowest levels in years. In many case the best we see offered in the field for 30 to 90 day supplies are below $1.30 per million Btu's. Let me assure you, not much new drilling will take place at that level.

Mr. Chairman, I am not here today to say we are about to have natural gas shortages -- because I don't believe we are -- in the near term. But I am troubled by the fact that virtually no one is focusing on what we can expect in the way of deliverable supplies in just a few short years.

We hear a lot these days about natural gas being the fuel of the future. As the debate goes on over acid rain and ozone depletion, everyone seems to think natural gas represents an answer to many of American's pollution control problems. In fact, much is being written about backing out oil imports with natural gas by altering our transportation fleets to use natural gas.

As a natural gas producer, I am excited at these prospects. As a realist I must warn the Committee, we will not be able to meet these demands at today's drilling rate. And as a businessman I know that we can't increase that drilling rate without significant positive changes in current financial incentives.

First and foremost, we need higher prices. Higher prices are the best and quickest way to increase producer drilling budgets. Unfortunately, petroleum pricing remains out of our control and we may not be able to sustain high enough prices to do the job.

Therefore, we are advocating a package of tax changes, to help in attracting additional revenue to the drilling industry. That legislation, covered by S. 234 and S. 449, and cosponsored by several Members of this Committee is designed to help get the U.S. drilling rig fleet back to work. While we know that legislation is under the jurisdiction of another Committee, it is a key element of a much needed national energy policy and IPAA knows your Committee is concerned about that.

In conclusion, Mr. Chairman, no matter how long we work at this legislative process, it will be impossible to come up with a "perfect" bill. We know some producers and some users would have liked to see the bill deregulate remaining controlled natural gas immediately. There are others who probably believe we should never decontrol.

A number of producers would like to see language which would mandate total pipeline rate reform as well as open access carriage and there is a need for legislation in both these areas. But we also are aware that there are those who want to prohibit the FERC from permitting distribution company bypass -- a move producers oppose. Likewise we hear of others who still would seek a legislative take-or-pay "fix", another move we would oppose.

Another issue which has received a flurry of attention recently has been the so-called "spud date" issue. From the standpoint of a number of independents, the Chairman's bill before you (S. 783), which is mute on this issue, would be preferable to the House-passed bill. However, I have talked to a number of those who have sought to modify the House bill and while they are strong in their support for change, they do not want to see this issue "kill" the process. The overall objective of final decontrol is of paramount importance.

Therefore, we again commend you for your efforts and urge the Committee to move quickly to resolve any differences and to pass legislation which can be approved by the full Senate and sent to the President

Thank you for your consideration and for giving us this opportunity to be heard.

WELLHEAD REVENUE

U.S. Crude Oil and Natural Gas

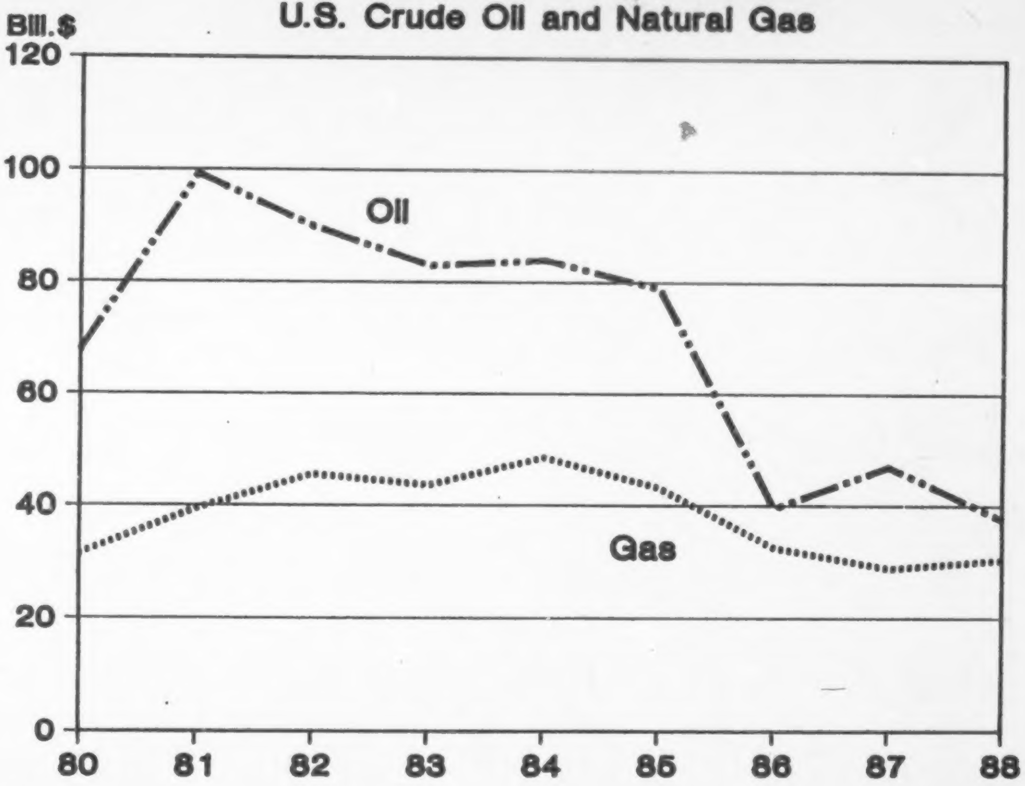
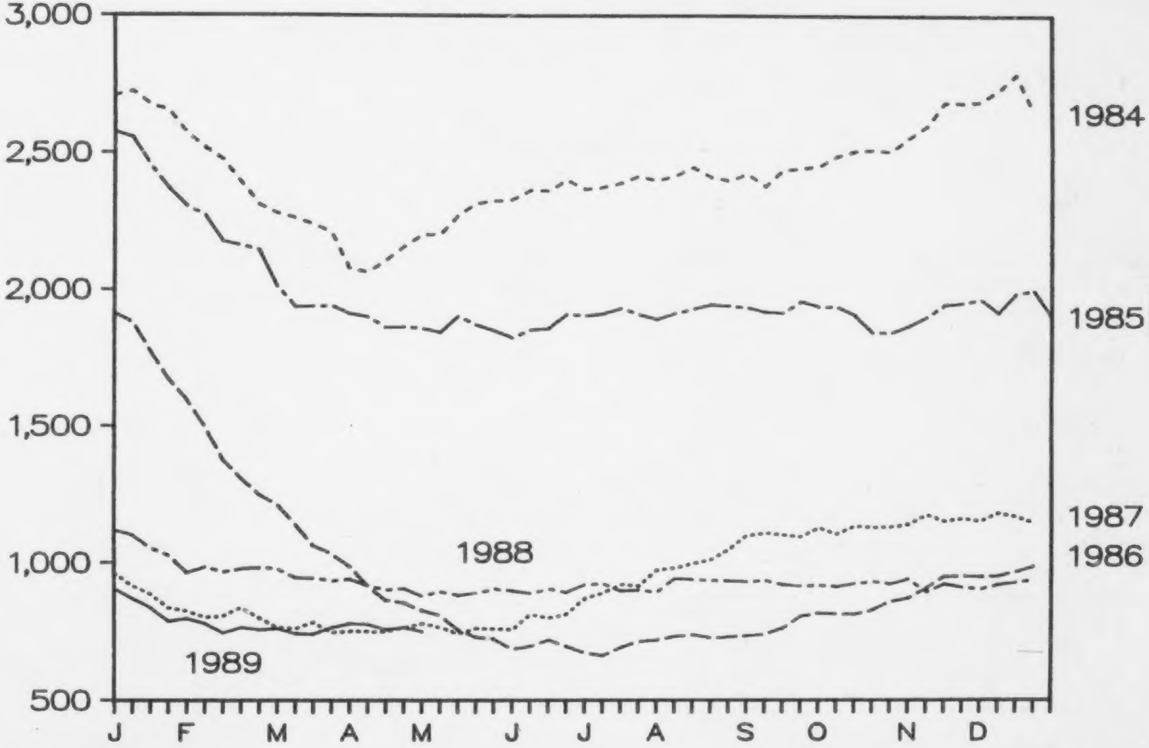


Chart 1

IPAA
4/89

ROTARY RIGS ACTIVE



Source: Baker Hughes, Inc.
Chart 2

IPAA
5/01/89

The CHAIRMAN. Ken Lay.

STATEMENT OF KENNETH L. LAY, CHAIRMAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, ENRON CORP., AND CHAIRMAN OF THE BOARD, INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA

Mr. LAY. Thank you. Mr. Chairman and members of the Senate Energy Committee:

I am Ken Lay. I am Chairman and Chief Executive Officer of Enron Corp. and also currently serving as Chairman of INGAA.

As most of you know, INGAA is the national trade association representing the interstate pipelines in this country. Our pipeline members deliver about 90 percent of all the gas bought and sold and transported in the interstate market, and thus we have a very strong interest in any change in the Natural Gas Act or the Natural Gas Policy Act or any other matter affecting FERC.

I am here this morning to say that INGAA unanimously supports S. 783 and H.R. 1722. Mr. Nickles, that is not saying anything about your bill. We would support it, too, but the other two, being very comparable bills, we think they are more likely of moving quickly through the approval process.

I guess on the comment that I think Senator Domenici made this morning, I suppose, like many of you, I have been involved in looking at this issue for at least 17 years, going back to days in government service. Senator Metzenbaum, I think clearly we have tried regulation. We tried extensive regulation throughout the sixties and seventies.

And of course, in the seventies it led to sharply higher prices throughout that decade, and of course severe shortages, shortages so severe that in many cases industrial users were tearing down plants in the Midwest and the Northeast and moving them to states like Texas and Louisiana, where an unfettered, deregulated market at least assured them availability of gas.

Our NGPA, as imperfect as it was, certainly set us on a course toward deregulating natural gas. Although it has been very complicated and obviously has had some problems, it has moved this industry significantly down the deregulation path, both as a pipeline industry and as a producing industry.

As the two previous gentlemen have commented, it has not been without its pain. In the case of the interstate pipelines, we have paid out about $8.5 billion to reform our contracts and pay off our take-or-pay claims. Of that total, about 40 percent of that has been absorbed by our shareholders, which of course is no small amount of money for an industry whose total investment in its facilities is about $20 billion.

We do believe that this industry and this country will be better served by a completely deregulated natural gas wellhead price environment. As we move forward, I think particularly as markets do come back into balance, which they are doing, and even moreso if we do have some fairly short supply situations, which are likely over the next two or three years, it is more likely we will get the response in drilling activity and the response in new supplies coming onstream quicker if all prices are deregulated, so producers can make their decisions as to where to drill wells based upon the economics of those decisions and not upon whether this particular field or this particular area is under an old regulated contract or a new deregulated contract.

We very much support the phase-in approach to deregulation, the date of 1/1/93 giving our members adequate time to continue working through some of the older contracts that still have onerous pricing provisions, particularly favored nations clauses.

We think most of those can be worked through by 1/1/93. and that is a matter both of having some time to do it, taking into account that this, the remaining controlled gas is represented in about 25,000 separate contracts, which will take some time just to get renegotiated to make sure that the transition is smooth. We are confident that will happen.

As to the spud date difference in the two bills, I think it is safe to say that, having surveyed our members, some members favor that wells spudded immediately be decontrolled, others favor that it not occur until 1/1/93. And since we typically agree with our membership, we are taking no position on that.

But we will be quite content with any date between those two or in that range, and we do believe it will be of very minimal consequence as to the costs that we incur and the prices that we charge our customers.

Again, I want to share with the other panel members in commending the Chairman and of course the membership of this Committee for continuing to grapple with this very difficult issue, and hope that this is the year that we will get all gas deregulated or on the path to deregulation. And I think that will serve this nation very well.

[The prepared statement of Mr. Lay follows:]

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA
555 13TH STREET, N.W., #300 • WASHINGTON, D.C. 20004 • 202/626-3200

STATEMENT OF MR. KENNETH L. LAY
CHAIRMAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, ENRON CORP.
and
CHAIRMAN OF THE BOARD
# of the
INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA
before the
COMMITTEE ON ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

May 8, 1989

Mr. Chairman and Members of the Committee:

I am Ken Lay, Chairman, President and Chief Executive Officer of Enron Corp. and Chairman of the Board of the Interstate Natural Gas Association of America (INGAA). I am pleased to appear before the Committee on behalf of INGAA to discuss the natural gas wellhead decontrol bills pending before the Committee, S. 783, S. 625, and H.R. 1722.

INGAA is the national trade association representing interstate natural gas pipelines and interproventlal Canadian pipelines. INGAA's members account for over ninety percent of the natural gas sold or transported in interstate commerce in the United States and our U. S. members are regulated by the Federal Energy Regulatory Commission (FERC or Commission) pursuant to the Natural Gas Act (NGA) and the Natural Gas Policy Act (NGPA).

Mr. Chairman, earlier this year, the gas industry was challenged to come forth with a consensus on a timetable for natural gas deregulation. I believe we have have met that challenge and INGAA is pleased to endorse S. 783 and H.R. 1722. While INGAA had originally supported a five year transition period to complete decontrol, we believe the January 1, 1993, date targeted by the bills will be sufficient to mitigate the adverse cost impacts and administrative difficulties that immediate decontrol would cause.

S. 783 and H.R. 1722 lift all wellhead natural gas price controls on January 1, 1993, and in the interim provide for decontrol of gas not subject to a contract on the date of enactment, gas subject to new or expiring contracts, and gas subject to renegotiated contracts (where the renegotiated contract so provides). In addition, H.R. 1722 decontrols gas from wells spudded after March 23, 1989.

With enactment by Congress, this legislation will bring to a close the era that began in 1954 with the Supreme Court's decision in the "Phillips" case (*Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954)), which led to the imposition of wellhead price controls on all natural gas sold into the interstate market for resale. It is not necessary to recite for this Committee the long, tortured history of wellhead price controls. Briefly the inability of the Federal Power Commission (the predecessor agency of the FERC) to adequately administer those controls created artificial shortages of gas in the interstate market that culminated with the severe curtailments of 1976-77. These shortages were artificial in the sense that there was not a physical shortage of gas, but real in that pipelines were unable to purchase supplies for the interstate market at the regulated prices allowed by the Commission.

In response to those shortages, Congress enacted the NGPA in 1978, which decontrolled the prices of gas from certain wells (primarily as of January 1, 1985), but which continued controls indefinitely on gas from older wells and leases and certain high cost or stripper wells. The NGPA pricing provisions represented a compromise between those seeking complete decontrol and those wishing to protect consumers from higher price increases. INGAA supported passage of the NGPA and despite flaws that may be more apparent in hindsight, it succeeded in eliminating the dual intra- and interstate market for natural gas and began the shift away from continued wellhead regulation of interstate natural gas.

The FERC has responded to the new competitive wellhead market with a whole series of orders transforming the structure of the natural gas industry. Traditionally, it was a primary responsibility of the pipeline to aggregate reserves of gas adequate to meet the demands of local distributors. As the competition in the production fields along with the collapse of the world oil market drove wellhead prices down, the FERC freed distributors from their purchase obligations to pipelines and effectively induced pipelines to become open access transporters of the gas purchased by those distribution customers and end users in lieu of pipeline system supplies.

Today, pipeline customers and end users now effectively control much of their own gas supply. However, those wellhead price controls that remain continue to distort the market by providing gas consumers with erroneous market signals - both high and low. The result of this distortion is that improper price signals are sent to producers who must explore and develop for gas in order to ensure long-term deliverability. As a consequence, producers may make improper decisions regarding their exploration and development activities, and consumers may be mistakenly relying on improper price signals for adequate supply.

It is now time for Congress to complete the process begun in the NGPA, and provide an orderly phaseout of these remaining price ceilings with a minimum of disruption so consumers can have direct access to all gas and can bargain on price and non-price terms for gas supplies.

INGAA believes the phased approach to decontrol, as opposed to immediate decontrol, is important for two basic reasons. First, many gas purchase contracts were written at a time when gas was in short supply or prior to the era of open access transportation, and therefore are not fully market responsive. It is true that the wellhead price "fly up" expected by INGAA and others did not occur in 1985, but what did happen was a "fly up" in take-or-pay exposure when the marketplace would not accept higher wellhead prices. As you know, a significant number of pipelines and producers suffered severe financial difficulties as a result, and today a portion of the cost of renegotiating those contracts is being passed through to consumers. It has taken the industry many painful years to renegotiate the bulk of the take-or-pay problem stemming from non-market-responsive contracts.

If all pipeline/producer purchase contracts were perfectly market responsive, immediate decontrol would indeed be appropriate, but unfortunately they are not. There still remain in effect contracts for price regulated gas containing provisions which, in the event of decontrol, result in price increases well in excess of market-clearing levels. For example, many gas contracts contain "most favored nations" clauses which provide that, upon deregulation, the price will be equal to the average of the two or three highest prices being paid under other contracts for gas in a specified geographic area. These provisions were included in contracts to encourage producers to explore and develop new gas supplies during the 1970s and early 1980s when interstate gas reserves were in short supply and curtailments to industrial users were increasing. Virtually any significant producing area will contain "other" contracts which provide for prices in excess of market-clearing levels. One such example would be contracts for Section 108 or Section 102(d) which in April 1989 have posted NGPA prices of $5.609 and $5.239 per dekatherm respectively. Wellhead decontrol notwithstanding, any of these contracts could and will serve as "marker" contracts for the "most favored nations" deregulation clauses. A likely result, then, is that immediate decontrol could trigger most favored nations clauses which would tend to increase the price in many supply contracts to well over $5 per MMBtu.

The impact of immediate decontrol would be substantial. INGAA surveyed its pipeline company members and found that immediate decontrol is likely to have two effects. The respondents reported that a potential increase in wellhead gas prices, if absorbed by the marketplace, could result in an increase of approximately $400 million to consumer bills in 1989 alone.[1] If the marketplace is not prepared to absorb an increase in gas costs, it is likely that a second wave of take-or-pay would befall the industry. Contract reformation costs resulting from additional take-or-pay have the potential of approximately $400 million which, to the extent these costs are prudently incurred, could be recovered through consumer's bills. The vast majority of pipelines reported that indefinite price escalator clauses have an important impact on pipeline systems.[2]

This discussion illustrates the critical importance of providing a transition period for decontrol. The 3-1/2 year transition period provided by the proposal now before this Subcommittee is necessary to give pipelines and producers the time and the incentive to renegotiate those contracts which remain above market or which would escalate to above market-clearing price levels upon deregulation.

Under immediate decontrol, producers with below-market contracts could receive an immediate increase in price to at least market-clearing prices, and in many instances to above market-clearing prices, without making any commitments in return. Obviously, presented with the prospect of immediate decontrol, a producer would have little, if any, incentive to renegotiate on other issues because he could immediately begin collecting the higher prices. On the other hand, if the producer knew he had to wait 3-1/2 years for decontrol, he would be much more likely to come to the bargaining table and address inflexible above-market contracts and future supply and reserve development issues in return for immediate market-clearing prices in below-market contracts. The longer the wait, the more incentive to renegotiate. Although we originally supported a five-year phaseout period for this reason, we believe 3-1/2 years is adequate. However, a shorter time period would be unacceptable.

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[1] In response to a December 1988 wellhead decontrol survey, INGAA received responses from 20 interstate pipeline companies representing 77 percent of the interstate natural gas market. Thirteen of the respondents had performed an assessment of the impact of decontrol. Nine of the thirteen reported WACOG increases, one reported no change, and three reported a decrease for an aggregate WACOG increase of $0.08 per MMBtu. Applied to the 4.8 Tcf of sales for resale in interstate commerce in 1988 as an approximation for 1989 volumes, the $0.08 per MMBtu results in a nearly $400 million increase in gas costs for that year alone.

[2] Eighteen of twenty respondents, including those unable to quantify the effects of decontrol, saw indefinite price escalators as being at least somewhat important to their systems.

The second reason for delaying the date of complete decontrol until 1993 relates to the sheer number of contracts affected. Producers and pipelines need the time to renegotiate these contracts to make them more market responsive before wellhead decontrol goes into effect in order to avoid a market-distorting price shock.

The task before the producer and pipeline industry is large. By INGAA's estimation, as many as 12,000 pipeline/producer negotiation efforts may need to be undertaken. These negotiations could involve over 27,000 individual supply contracts which appear to contain pricing provisions that prevent the effective contract price from being market responsive.

If decontrol took effect immediately upon enactment of a bill, each contract decontrolled would have to be examined to determine whether the price under that contract was affected. To the extent that pipelines and producers disagreed as to the appropriate price, further discussions and negotiations would be required. In addition, other contracts that may not have been subject to the price ceiling but which are not market responsive could also require renegotiation, as pipelines sought to keep their weighted average price competitive.

Many of these problems are avoided or mitigated by extending the date of decontrol. During the time frame provided by the legislation, many of these contracts will either expire or be subject to renegotiation during the normal course of business. I realize it may be difficult for Members of this Committee to appreciate the amount of resources and time involved in redetermining prices for thousands of contracts, but it is substantial. This reason alone is sufficient to warrant some phasing of the decontrol timetable.

I would like to address the "newly spudded well" provision that is included in H.R. 1722 but omitted from S. 783. As I stated at the outset, INGAA can support either bill. For most companies, it is difficult to estimate with any precision the impact that decontrol of newly spudded wells would have on prices. Much could depend upon the pipeline's mix of gas. Notwithstanding some pipelines believe the provision will act to exert downward price pressure overall while others believe it would lead to upward price pressure. In evaluating H.R. 1722, the Association concluded that the overall impact of the provision was not so onerous as to jeopardize our support for the bill. By the same token, its impact does not appear so beneficial as to cause us to advocate its inclusion in S. 783. However, we do hope that the two bodies will not allow this single difference to become an insurmountable obstacle that blocks final passage of a bill.

I must note, for the record, that INGAA's support for decontrol legislation is conditioned on the premise that the bill does not become a vehicle for other controversial issues, or that the January 1, 1993, date does not change to an earlier time. INGAA was pleased that in the last Congress, several worthwhile, noncontroversial natural gas-related bills were enacted without becoming entangled with the kinds of disputes that have blocked passage of gas legislation since enactment of the NGPA. Now that we have this opportunity to get the decades of unproductive wellhead price controls on interstate natural gas behind us, it would be unfortunate if unrelated issues were injected into the legislation, upsetting the coalition of support for wellhead decontrol.

In conclusion, INGAA urges swift action by the Committee and the Senate on S. 783. I thank the Committee for this opportunity to appear and will respond to any questions Members may have.

The **Chairman**. Thank you, Mr. Lay.

Mr. Schusterman.

STATEMENT OF CHARLES SCHUSTERMAN, CHAIRMAN AND PRINCIPAL OWNER, SAMSON INVESTMENT CO.

Mr. **Schusterman**. Good morning, ladies and gentlemen. I want to thank you for allowing me to speak before you.

I am from Tulsa, Oklahoma, and I am the Chief Executive Officer and principal owner of Samson Investment Company. I also happen to be a petroleum engineer, so I am technically trained in this business.

Samson is a domestic independent oil and gas producer whose primary activity is the exploration for and production of natural gas in the United States. We employ approximately 300 people and have activities in 13 states. Looking across this panel, I see that we produce in all the states except Kentucky.

We produce 2500 barrels of oil——

Senator **Ford**. Has that helped you any? [Laughter.]

It just proves, maybe I am in the wrong place.

Mr. **Schusterman**. What can I say.

We produce 2500 barrels of oil per day and 150 million cubic feet of gas per day. Therefore, approximately 90 percent of our production on a heating basis value is natural gas. This is enough gas to heat approximately 600,000 homes per day each and every year.

I might also add to Senator Bumpers that I am quite familiar with those fields that you expressed, because we used to be the largest supplier of natural gas to Arkansas Louisiana Gas, which is your principal utility. So we do certainly understand those areas.

We produced no gas in 1973. Virtually all of this gas has been discovered since the energy crisis of the early 1970's. We clearly responded to the energy crisis and the incentives provided by the marketplace and the government.

Now, we believe the proposed complete deregulation of natural gas that we are discussing today will have almost no financial impact on the consumer over the short term. We believe it will have, however, a significant negative impact on the consumer when the next energy crisis comes to the United States.

However, there will be increasingly negative impact on domestic independent producers of natural gas by causing a flow of capital from domestic producers and exploration companies to the very large, multinational, integrated oil companies and interstate pipelines. It is these entities that support most of the organizations that you will hear from today.

It has been our company's philosophy to be as efficient as possible in exploring for natural gas. This efficiency allows us to provide gas to the consumer at the lowest price commensurate with the risk we must absorb in our operations.

Our view of the future indicates that there is potentially a lot of gas to be discovered in the United States. But I want to emphasize, much of it is located in small reservoirs, some of which are currently known, that require more efficient development.

The pipeline companies, with billion dollar net worths, and the multinational diversified major oil companies are not set up to efficiently develop much of these same remaining domestic gas reserves. These reservoirs need to be developed to increase deliverability.

Unfortunately, it looks like the companies that solved the problems of the 1970's might not be around to solve the problems of the 1990's. Look at the drilling activity, which is near historic lows, and the reduced enrollment for courses dealing with our industry in the universities.

The continually weakening financial structure of the domestic independents will not allow us to effectively respond to the needs of the consumer in the 1990's. That will be costly to the consumer as they use natural gas. We think providing the lowest priced gas possible to the consumer is in the best interests of our country.

It is the domestic independent explorationist who responded vigorously to the gas shortages of the middle 1970's by borrowing money and drilling wells in a time of extreme price volatility. The continued erosion and demise of that section of the business has been well documented, so I will not go into the details of what has happened to our portion of the industry.

But I would like to state one quick position here with regard to the Oklahoma Independent Petroleum Association position, and I read it as follows: "Although the proposed deregulation legislation will have a negative economic impact upon many domestic independent gas producers, OIPA maintains its longstanding position in favor of natural gas deregulation."

The CHAIRMAN. Your time has expired. Could you sum up in a sentence?

Mr. SCHUSTERMAN. I will sum it up now. I just want to read this last part: "Provided it does not abrogate contracts."

Now, within the rest of my written comments I have gone into specific examples of how contract abrogation affects us. I have a proposed amendment that I would like for this Committee to consider, and that will conclude my stated remarks.

[The prepared statement of Mr. Schusterman follows:]

BEFORE THE

SENATE COMMITTEE ON ENERGY AND NATURAL GAS RESOURCES

STATEMENT OF

CHARLES SCHUSTERMAN

CHAIRMAN AND PRINCIPAL OWNER

SAMSON INVESTMENT COMPANY

MAY 8, 1989

STATEMENT OF CHARLES SCHUSTERMAN

BEFORE SENATE COMMITTEE ON ENERGY AND NATURAL RESOURCES

Good morning ladies and gentlemen. My name is Charles Schusterman and I want to thank you for the opportunity to speak to you. I am from Tulsa, Oklahoma, and I am Chief Executive Officer and principal owner of Samson Investment Company. I am also a petroleum engineer. Samson is a domestic independent oil and gas producer whose primary activity is the exploration for and production of natural gas in the United States. We employ approximately 300 people and have activities in 13 states. We produce 2500 barrels of oil per day and 150 million cubic feet of gas per day. Therefore, approximately 90% of our production on a heating equivalent basis is natural gas. This is enough natural gas to heat approximately 600 thousand homes for each and every year. We produced no gas in 1973. Virtually all of this gas has been discovered since the energy crisis of the early 1970's. We clearly responded to the energy crisis and the incentives provided by the market place and the government.

I want to make it clear at the outset that my position is different from the majority of people you will hear today. And with good reason. The proposed complete deregulation of natural gas, which we are discussing today, will have almost no financial impact on the consumer over the short term future. We believe it will have a significantly negative impact on the consumer when the next energy crisis comes to the United States. However, there will be an increasingly negative impact on domestic independent producers of natural gas by causing a flow of capital dollars from domestic independent exploration companies to the very large multi-national integrated oil companies and interstate pipelines. It is those entities that support most of the organizations you will hear from today.

It has been our company's philosophy to be as efficient as possible in exploring for natural gas. This efficiency allows us to provide gas to the consumer at the lowest possible price commensurate with the risk we must absorb in our operations. Our view of the future indicates there is potentially a lot of gas to be discovered in the United States but much of it is located in small reservoirs, some of which are currently known, that require more efficient development. The pipeline companies with billion dollar net worths and the multi-national diversified major oil companies are not set up to efficiently develop much of these remaining domestic gas reserves. These reservoirs need to be developed to increase deliverability. Unfortunately, it looks like the companies that solved the problem of gas shortages in the 1970's might not be around to solve the problem of the 1990's. Look at the drilling activity which is near historic lows and the reduced enrollment for courses dealing with our industry in our universities. The continually weakening financial structure of the domestic independents will not allow us to effectively respond to the needs of the consumer in the 1990's. That will be costly to the consumer as they use natural gas. We think providing the lowest priced gas possible to the consumer is in the best interests of our country.

It is the domestic independent explorationist who responded so vigorously to the gas shortages of the middle 1970's by borrowing money and drilling wells in a time of extreme price volatility. The continued erosion and demise of that segment of the business has been well documented along with that of many financial institutions, and I will not burden you with a repeat of that story here today. However, it is noteworthy that the remaining domestic independent gas producers and explorationists from the late 1970's and early 1980's, are now being asked to bear another significant financial burden.

There are still remaining many small and medium size independent gas exploration companies. Our smaller numbers and our weakened financial strength has not allowed us to adequately deliver our message in Washington. However, the official position of the Oklahoma Independent Petroleum Association on natural gas deregulation should be read into the record. It is as follows:

> Although the proposed deregulation legislation will have a negative economic impact upon many domestic, independent gas producers, OIPA maintains its long-standing position in favor of natural gas deregulation, provided it does not abrogate contracts (as several of the current proposals appear to do).

We are 100% in agreement with this position.

The effective abrogation of contractual understandings threatens a basic and historic cornerstone of American business. Since many of you may question my statement that this law, as currently proposed, will lead to contract abrogation, I want to take a moment now to specifically explain my comment. Samson, like many independent gas producers, has numerous gas purchase contracts which contain a two-part pricing provision. The first part of the pricing provision was drafted when the contracts were originally entered into many years ago and includes a very low stated base price based on the then current controlled market for gas of between 15 and 20 cents with annual escalations of between one and four cents per year. It was the inadequate pricing in these provisions that led to the shortages we experienced in the middle 1970's. As a result of these shortages, in the late 1970's, these same contracts were amended to include area rate clauses which allowed for prices to be set pursuant to the regulatory provisions at that time for newly drilled wells. These contract amendments allowed the price paid for natural gas to rise and thus allowed producers to explore for the much needed new supplies of natural gas. It has been the interpretation of interstate pipeline companies that the currently proposed legislation will nullify the area rate clauses since the prices established by these provisions were based on regulatory provisions which would no longer be in effect. They contend that such a nullification could force these contracts back into the 20 and 30 cent pricing provisions for all gas produced pursuant to those contracts because several of these contracts do not have provisions for dealing with setting prices in the event of deregulation. The effect of this would be to render the production of that gas uneconomic. Clearly, going back to such low prices was not the intent of the parties at the time the contracts were amended and new wells were drilled based on the economics provided for in the contracts. However, the pipelines may operate under the interpretation that prices should fall back to the 20-30 cents provisions, whether or not that is correct and many independent producers like Samson do not agree but, if we have learned anything in the domestic independent gas business in the last few years, it is that if you want an interstate pipeline to honor its contract and not abuse every word set down by regulatory bodies, you must be willing to drag them into Federal District Court and/or state courts and spend 5 to 10 years to get your contract enforced. Such proceedings only benefit lawyers and raise the price of natural gas to the consumer.

I realize we are discussing extremely complex issues today, and the results, therefore, cannot be foretold with certainty. However, we believe the ramifications of the proposed legislation will be to cause great economic distress to the independent domestic natural gas industry and thus will ultimately negatively impact the consumer by causing severely decreased drilling, lower royalty payments, and lower severance taxes to states already in economic straits. It will also negatively impact the country as a whole by causing a decreased supply of the cleanest burning energy source available, an energy source which can provide gas fired cogeneration and cleaner air. Additionally causing increased financial burdens for the independent gas producer can lead to increasing loan losses, several of which loans are now owned by the FDIC.

It is certainly no secret that the domestic independent industry has undergone massive consolidation in recent history and the concentration of power among a few large companies is already very significant. Because such a trend is not good for the country, we ask that, prior to making any decisions on this matter, you consider the true impact of what you propose as it affects an extremely important segment of our country's economy, the domestic natural gas energy industry, and its affects on the consuming public.

To provide specific direction to this Committee, I would like to propose some language for you to consider as you develop amendments to make this a more effective bill.

Many gas contracts reference the NGPA or actions by the FERC in setting prices or establishing price escalation factors. These contracts often refer to portions of NGPA Title I that will be repealed by the currently proposed bill. Since we expect that it is not the intent of those drafting this bill to undermine the intent of the parties to these contracts, we would propose the following amendment:

> In the case of any contract for the first sale of natural gas without a provision establishing a specific pricing mechanism in the event of decontrol of previously price controlled gas, the price for such natural gas on and after January 1, 1993, shall be the price paid for last deliveries of such natural gas occurring on December 31, 1992, or, if no deliveries occurred on such date, the price that would have been paid had deliveries occurred on such date. This provision shall operate until the expiration of such contract.

We feel that such an amendment would aid the active independent gas explorationist and, therefore, increase the deliverability of our domestic energy supplies, and this will aid the consumer.

Thank you for your time and consideration.

The **Chairman**. Thank you, Mr. Schusterman.

If we may limit this maybe to just one question, one or two questions.

Mr. Conklin, IPAA certainly in numbers and I guess in influence is made up largely of independents, smaller independents, rather than the majors, and you are for this legislation.

Can you tell me why it will give incentive to find new gas?

Mr. **Conklin**. Well, I think eventually, Mr. Chairman, that the supply and demand formula will signal us as suppliers of natural gas and that the demand will bring us back into drilling. And I think that I agree that short-term the prices will decrease the independent ranks. Long-term, we hope that the signal will be that we should find the smaller reservoirs and it will be economical.

The **Chairman**. Senator Domenici?

Senator **Domenici**. I was going to ask Mr. Lay about the concern that somehow between producer affiliate treatment versus treatment of non-affiliates, but I am going to leave that alone and ask Mr. Conklin a question.

Mr. Conklin, this bill provides that the 107 gas cannot be a marker for indefinite price escalation clauses. Are you concerned at all that a pipeline might have a high-priced 107 gas which it does not worry about as far as it raising other producers' prices?

Could we not see a non-affiliate having a 107 price forced down by the market, while a pipeline affiliate would stay at a higher price?

Mr. **Conklin**. Well, we could see the prices forced down, absolutely, by decontrol. It depends on the way your contract would read, really. I am sure there are contracts—I have some contracts that are going to go down on decontrol.

Mr. **Lay**. But Senator Domenici, again for NGPA purposes the pipelines have to treat the affiliates and non-affiliates the same way, or else they have got PGA problems.

Senator **Domenici**. I did not hear your last comment.

Mr. **Lay**. I said they will have serious PGA problems, in other words prudency problems, if pipelines do not treat non-affiliates the same way they treat their affiliates. And that has been true ever since NGPA was passed.

Senator **Domenici**. I understand that.

I will get a more specific question on that to both of you, since one is an independent and one is a pipeline. I would like to get your answers.

Thank you, Mr. Chairman.

The **Chairman**. We would like to submit questions in writing to all witnesses, because obviously we do not have time orally to go over all of them.

Senator Metzenbaum.

Senator **Metzenbaum**. Mr. Schusterman, what are the prospects for independents such as yourself in the natural gas business, and would you comment on your ability to compete with the major oil companies as to whether that ability is improving or worsening over time?

Mr. **Schusterman**. Well, we see our position significantly eroding. It certainly has eroded and it is continuing to erode, and we frankly project a continuing erosion with this contract abrogation part.

So as it relates to the majors, we think that this particular bill helps the majors and therefore it reduces our ability to compete, because this gives them the ability to increase the prices on old gas and therefore it will strengthen them in relationship to our exploration effort and therefore decrease our competitiveness.

Senator **METZENBAUM**. Thank you.

The **CHAIRMAN**. Senator Nickles.

Senator **NICKLES**. Mr. Chairman, to kind of follow up on that same line to Mr. Schusterman, I read your statement and the part that you did not quite get to, that mentioned that you have some contracts that either you are aware of or at least that maybe your company has, that you are thinking that if this bill passed as it is—would it abrogate those contracts or would it put pressure on those contracts to revert back to very low prices?

Mr. **SCHUSTERMAN**. Well, we think one of the effects could be, although we are not certain—we will have to test it in courts, of course—we feel that it could push some of our prices in fact back to the 30 cent, 40 cent level, because our contracts stay in existence in relationship to the specific pricing. So our plan will be to in fact litigate this.

Now, I do not like litigation, but it seems like under certain policies associated with the abrogation of contracts we are continually forced to spend a large amount of our effort with lawyers and in the courts, working through these contracts, as opposed to spending our effort in finding natural gas.

We are out there in the field drilling wells. We are the third largest in Oklahoma insofar as activity is concerned. And I just do not like the diversion of effort that we have, and I think this particular bill in certain aspects has an element of the ability to start additional arguments with regard to the abrogation of contracts.

Senator **NICKLES**. Okay. Well, I want to make sure it is understood, because I am one of the principal authors of the legislation. This bill does not abrogate contracts, and I have stated all along. And Mr. Chairman, we have worked on this legislation for a long time. It does not abrogate contracts.

Now, there may be specific contracts that are tied to artificially designated prices that are by Congressional mandate, that individuals and firms, et cetera, may have tied to, that those contracts may need to be changed. I would think that those changes would revert, not to 20 or 30 cents, but that they would change to market forces, market-dictated prices. That would be my expectation.

I do not doubt—I think I heard one of our previous witnesses—maybe, Mr. Lay, you mentioned it—that there are something like 25,000 contracts or something that may have to be changed or amended in the next few years. I do not doubt that there may be more.

But it is my expectation, my thought, and my hope and desire that we not open up a multitude of litigation, that really we would see contracts be reverting to market-dictated prices.

Mr. Schusterman, are most of your contracts—and you have a lot—are most of those market-sensitive or most of them pretty close to the market today?

Mr. SCHUSTERMAN. As it relates to the eighties, they are market-sensitive, and that is why in the short term this deregulation bill we can support, because it really has no effect on us as it relates to the 1980's.

The great, great, great bulk of our contracts are market-sensitive. So it is really a narrow range when we were aggressively going out and finding natural gas in the seventies that this really, the bill affects us negatively.

Senator NICKLES. Which would have a downward pressure on some of those prices that were written in maybe the early seventies?

Mr. SCHUSTERMAN. In some contracts where we have old gas, we would have a price windfall. Our prices would go up in some cases. But I knew that when we got those contracts.

Our new contracts from the seventies would in fact go down in price, and I find that a little depressing from the standpoint because we spent new dollars at costly amounts in the seventies to do that. So old, cheap gas we get a windfall on, and our new activity we get hurt on. And somehow I do not think that is right in relationship to the contracts that we have in effect.

Senator NICKLES. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Metzenbaum—I mean, Senator Ford.

Senator FORD. Anybody at the table want to take on how you feel that it would impact the natural gas industry with new acid rain legislation?

Mr. BUSH. Senator, I think that natural gas has the opportunity to make a real contribution in terms of——

Senator FORD. Additional sales?

Mr. BUSH. Well, not only additional sales, but if we are ever going to solve the acid rain problem, eventually gas and coal are going to be an important combination, especially in large power plant generating facilities, in which, if we want to get to the point where we move past scrubbers as the only answer to dealing with those kinds of facilities, we are going to have to use gas and coal in combination for clean-burning technologies.

I think it will accelerate——

Senator FORD. You are talking about direct burning now?

Mr. BUSH. Yes, I am talking about the opportunity for gas to find its appropriate niche with coal in significant power facilities. For that to occur, one of the things that we have to do is straighten out the natural gas industry so important consumers, large electric generating utilities, industry and others who consume nearly 60 percent of all the natural gas in this nation, have confidence that this industry is doing its business driven by marketplace economics and not by ever-changing, volatile regulation.

So I think it is a big plus to the future.

Senator FORD. How many new boilers are being built that burn coal and how many are being built that burn natural gas?

Mr. BUSH. I do not have the current data on that, but I would assume the large ones are all going to be coal.

Senator FORD. None are being built for coal. They are all being built for natural gas, and that is a fight we had back in the past.

So we are drifting into a position where natural gas will be a necessity, and the ability to handle that I think is going to increase the price. I am very concerned about some of the push that is being made as it relates to acid rain by the natural gas people and that, instead of trying to see that we have a distribution of resources, we find it is just a direct use of one.

Kenneth, go ahead.

Mr. LAY. Senator, and I do not intend my answer to indicate that maybe you have got an interest in the coal industry, too, but we really believe in——

Senator FORD. If I do not have, I ought to resign.

Mr. LAY. But we do believe that in many cases co-firing at existing coal facilities with some percentage, maybe 10 or 15 of gas, will in fact substantially reduce sulphur dioxide emissions in particular and help achieve some new standards, but still leaving 85 or 90 percent of that old power plant burning coal on a year-round basis.

So I think in many cases gas may offer a cheaper alternative to retrofitting old plants or shutting them down maybe in some cases, and of course at the same time keep more coal being burned, because I think we all understand that coal is our largest fossil fuel resource in this country and we have to utilize it.

Senator FORD. Well, just the problem I have is that all new boilers are gas-fired. And we just have one little teeny amendment on the books that helps us—maybe. And you guys beat me over the head pretty dang good, and I see some folks out there peaking around the heads who did a pretty good job on me.

But now we find that this move is just for direct burning and we are moving into that arena, that means a greater demand and a greater need for supply. And it is not out there—you have 700 wells going, drills, right this past month, 700 rigs out.

I just wanted to be sure that I put up the alert that I am not going to be too happy about some of the push.

Mr. CONKLIN. Senator, it so happens that I am on the board of a public utility company that half of our capacity is gas and half is coal. And when you look at the long-term plan as far as the price is concerned, their plans are to stay in the coal business. It has been very efficient for them, and that is right in Amarillo.

Senator FORD. Yes. As the oil prices go up, and we have watched them bounce pretty good in the last few weeks, that means natural gas is going up with that oil, too.

Mr. CONKLIN. But I have not seen what effect, though.

Senator FORD. Oh, you will, because the estimate and the reputation laid on the line here was that price is based on oil. You do not want to defame the reputation of a man who is Assistant Secretary of Energy, would you?

Mr. CONKLIN. Absolutely not.

Senator FORD. Absolutely.

Mr. CONKLIN. There can be a difference of opinion.

Senator BUMPERS. What is the company, Mr. Conklin?

Mr. CONKLIN. Sir?

Senator BUMPERS. What is the utility company?

Mr. CONKLIN. Southwestern Public Service Corporation.

Senator BUMPERS. Where is that?

Mr. CONKLIN. It is headquartered in Amarillo. It is a regional company.

The CHAIRMAN. Senator Conrad?

Senator CONRAD. I am going to return my time to the Chairman in the interest of moving through these witnesses.

The CHAIRMAN. Excellent, excellent idea.

Senator Bumpers, did you have additional questions?

Senator BUMPERS. Yes.

The CHAIRMAN. Still more?

Senator BUMPERS. This will only take about 3 minutes, Mr. Chairman.

Mr. Schusterman, is that right?

Mr. SCHUSTERMAN. Schusterman.

Senator BUMPERS. Mr. Schusterman, I have looked at your amendment and I think there is some merit in it. It is obvious that nobody ever intended in the case of decontrol for prices to revert back to 20 to 30 cents. I am not sure your language here is as precise as it ought to be, and I looked at it very closely.

Since you operate in eastern Oklahoma, do you have holdings in western Arkansas also?

Mr. SCHUSTERMAN. Yes, we are actually probably in every one of those fields that you mentioned. Like I say, we are the largest supplier—were the largest supplier to Ark-La, so that is the heart of our operation in many ways.

Senator BUMPERS. Does your company have any of those fixed fee contracts?

Mr. SCHUSTERMAN. As you mentioned that, the answer is I am not aware of any of those type of contracts.

Senator BUMPERS. I do not think you would have been the initiator of them, but I think that you might have in purchasing contracts or purchasing working interests from others, might have been the indirect beneficiary of them.

Mr. SCHUSTERMAN. To my knowledge, I do not have specific information that any of those type of low-priced fixed prices are in the contracts. They may be, because we have hundreds or maybe thousands in Arkansas of leases.

Most of our contracts, most of our leases, I believe would be one-eighth of the market price at the wellhead. Now, that is my personal opinion.

Senator BUMPERS. Well, of course, you know, since the 1960's all the contracts are at one-eighth of the value. As a matter of fact, some people are getting 3/16 these days.

But once the people began to catch on to what had happened to them, they became pretty tough bargainers and they learned to hire brilliant lawyers like the senior Senator from Arkansas to take care of their interests, so we stopped that stuff.

But until that—it was about I would say probably the early sixties that people became aware of what had happened to them, and of course they began to sign contracts not only with bonus bids far in excess of a dollar an acre, but also got one-eighth of the value of the gas, which is what they thought they were getting all along.

Do you have any personal objection to putting a provision on this bill as I indicated a moment ago?

Mr. SCHUSTERMAN. Insofar as protecting contracts, I am always interested in protecting contracts. And certainly addressing what I consider to be—what you are talking about was some real inequities in relationship to the Arkansas royalty owner.

And I would also be quite willing to research our records to see specifically how that applies for our production in Arkansas. Since we are fairly new boys on the block, basically starting since 1973, most of our leases are in fact new in Arkansas, and any leases that we would have purchased from prior years, which would have been from the major oil companies, would generally not go further back than probably the 1950's.

That is probably the reason why I mentioned that we do not have any situations that I can recall that are like you represented.

Senator Bumpers. Well, Mr. Schusterman, considering——

The Chairman. Senator Bumpers, we have got another five minutes. I hate to cut you off.

Senator Bumpers. I hate for you to, Mr. Chairman.

Mr. Schusterman. I would be happy to talk to you however you so choose.

Senator Bumpers. Mr. Schusterman, as Senator Ford has correctly pointed out, the Clean Air Act is going to come sailing through here, which is going to make gas highly desirable in the future.

We have the warming effect, the greenhouse effect. And as you know, natural gas has about half the CO_2 content that oil has. That is going to put tremendous pressure on gas supplies.

I can conceive of gas in the next five, six years going to four to ten dollars an MCF and, because of this deregulation, there will be no control of price on it. Does it not seem inequitable to you, and to you other gentlemen for that matter, for a royalty owner to still be stuck with say 16 cents, while we decontrol price and it just continues to escalate and the royalty owner gets no benefit of the increased price?

Mr. Schusterman. I think certainly the royalty owner should participate along with the producer. Our position as you articulate that situation is to try to hold our company together for that shortage that I see coming in the 1990's, because I do not think I am going to have very much competition for those small reservoirs that I am talking about, those small reservoirs in Arkansas.

Senator Bumpers. There is not too much now. Those are all drilled out and the only thing you are going to find are small reservoirs there probably in the future.

Mr. Schusterman. That is what exists in Arkansas. I will not get into the technical details, but that is what you have in the areas you are speaking of.

Senator Bumpers. Thank you, Mr. Chairman.

The Chairman. I have just one question, Mr. Schusterman. When you say that this law would abrogate contracts, really what you have in mind is those contracts which adopt a regulated price under NGPA and that by deregulating you have no reference price under the law, is that not correct?

Mr. Schusterman. That is exactly correct.

The Chairman. Thank you very much, gentlemen.

Next we have a group of five witnesses which we will combine into one panel: Mr. Edwin Rothschild, Assistant Director of the Citizen-Labor Energy Coalition; George Lawrence, President, AGA; Gordon Gooch, lawyer with Travis and Gooch; Robert McPhail, General Manager of Basin Electric Power Cooperative in Bismarck, North Dakota; and Mr. Lee Liberman, Chairman of the Board and President of Laclede Gas Company in St. Louis.

Why do we not begin with Mr. Rothschild and, so that others can—obviously, we are going to put in all written statements into the record so that we can have a little give and take here on some of the central questions about the effect on consumers and supply.

Mr. Rothschild.

STATEMENT OF EDWIN ROTHSCHILD, ASSISTANT DIRECTOR, CITIZEN/LABOR ENERGY COALITION

Mr. ROTHSCHILD. Thank you, Mr. Chairman.

It was not too many years ago we were here discussing the Natural Gas Policy Act, and I do appreciate the opportunity to testify on this legislation this morning.

First off, I would just like to point to the chart we have attached to the back of our testimony, which really indicates the basis of our concern here. This chart shows the changes in wellhead prices, industrial prices, and residential prices between 1981 and 1988.

As anyone can see, the industrial prices fairly well tracked the decline in wellhead prices, but that the gap that used to exist between the industrial price and the residential price has continued to widen, which means the primary beneficiaries, although residential customers have gotten some benefit, albeit very moderate, the primary beneficiaries have been large industrial users.

I think when people talk about consumers, they need to identify who in fact we are talking about. Residential consumers have not been the primary beneficiaries.

We think, Mr. Chairman, that the legislation before this Committee is basically a special interest bill. There are special interests who have made the special pleadings as to why they need this bill today, and they are apparently on their way to getting it, as we saw what happened in the House.

The problem, of course, is when you make changes, some people get their concerns recognized and some people do not. Ashland Oil was concerned about the March 23rd date and they got that changed here.

Ashland Oil is not a heck of a big producer. I mean, I have got their 10k here and they only drilled a few wells during 1988. I mean, to change the bill because they are concerned about some impact on their existing contracts seems to me to raise the real issue here.

The real issue here is, people have talked about contract abrogation. This bill would abrogate old gas contracts. It clearly would abrogate old gas contracts, which the Congress when it passed NGPA said old gas controls would remain in effect forever, because we were going to deregulate new gas, and that was the deal that was made.

Now that deal is being broken in the belief that some people said gas prices are going to come down. I do not believe gas prices will come down. I think other market factors will drive gas prices up. And I think the people on the previous panel and the panel before this one and this one will, when they look at the facts, will say, yes, gas prices are going to go up.

Secondly, some people's gas prices will not come down. The way the gas bill is structured, namely to raise old gas prices and lower high cost gas prices, we have seen Mr. Schusterman is concerned and wants an amendment to protect his gas prices.

But the phasing out of gas prices towards decontrol favors those who have high-cost gas and allows them to keep their higher prices for a longer period of time.

We think that the consumers need to have some benefits, and I thank Senator Metzenbaum for pointing out some of these things that are missing from the legislation. What is missing from the legislation is any consideration of contract problems, contract provisions that will affect prices. Absent from the legislation is any provision to deal with the problems of take-or-pay which are being foisted upon residential consumers, thanks to the FERC.

There is a failure to deal with the bypass question, again thanks to the FERC, which are causing residential rates to increase and that gap between industrial customers to rise.

Again thanks to the FERC, there is no real open access for firm transportation. Yes, there have been changes for interruptible transportation, but not for firm gas. So residential consumers cannot obtain direct benefit of those lower gas prices because they have no access to the pipeline system.

This failure to deal with continuation of Order 451. There is no mention that you are going to repeal Order 451, that now the producers can avail themselves of higher prices and can abandon natural gas contracts that are supposed to be continued on into the interstate market. I see no mention of that.

In fact, AGA and INGAA both are concerned about that provision, because they made that statement very clear in their appeal of Order 451 to the Fifth Circuit Court of Appeals, which had oral argument just this past month.

Statements have been made both here and in the House that the lower prices will come out as a result of this bill, but producers say they are not going to drill unless prices are higher. I see an inconsistency there.

Finally, Mr. Chairman, I just want to mention that the National Association of State Utility Consumer Advocates, which had requested to testify and which was not given the right to testify this morning, does have a written statement and I think very, very clearly articulates some of the specific reasons of why this legislation is not good for consumers.

I will conclude there, Mr. Chairman, and I would be happy to answer any questions.

[The prepared statement of Mr. Rothschild follows:]

Statement

of

Edwin S. Rothschild
Assistant Director

Citizen/Labor Energy Coalition

on

The Decontrol of Wellhead Natural Gas Prices

before the

Committee on Energy and Natural Resources

United States Senate

May 8, 1989

Mr. Chairman and members of the committee. My name is Edwin S. Rothschild and I am the assistant director of the Citizen/Labor Energy Coalition. We very much appreciate the opportunity to testify today on legislation to decontrol the remaining price ceilings on natural gas.

Despite the huge groundswell of support for a three-year phaseout of controls by the various segments of the gas industry, there are some who are highly critical of this effort. Besides ourselves, the Consumer Federation of America (CFA), the American Public Gas Association (APGA) and the National Association of State Utility Consumer Advocates (NASUCA) are all opposed to decontrol, particularly in light of the fact that this legislation studiously avoids dealing with important issues like: local distribution company bypass, the take-or-pay problem, the producer/pipeline contracts problem and mandatory contract carriage.

The fact that the major Washington natural gas trade associations -- the Natural Gas Supply Association (NGSA), the American Petroleum Institute (API), NGSA's older but weaker sister, the Independent Petroleum Association of America (IPAA), the Interstate Natural Gas Association of America (INGAA), the American Gas Association (AGA) and the Process Gas Consumers (PGC) -- support decontrol is not surprising. The members of NGSA -- major gas producers -- get what they have lusted after for the last 35 years. And even though they would prefer immediate decontrol (because of their large reserves of low-cost and low-priced "old" gas), they are willing to accept a quick phase out. Some of the other special interests in gas industry, are not so enamored of immediate decontrol. Among the first to express their fears were representatives of IPAA. Because some of their members have gas contracts without price protection provisions, immediate decontrol would have sharply reduced their contract prices. As the IPAA's Chairman, Danny Conklin, explained it in his January 31, 1989 letter to Rep. Philip Sharp, chairman of the House Subcommittee on Energy and Power:

> At the time the Natural Gas Policy Act passed, all of us assumed that decontrol would result in higher prices. Therefore, any contracts written in the wake of NGPA, endeavored to capture the highest lawful price until decontrol, and then assumed the price would "hold" or rise.
>
> We all know what has happened. Stripper wells that have tracked NGPA ceiling prices, for example, could drop in price to levels less than one third of pre-decontrol because the mere act of decontrol would, in effect, "abrogate" the existing pricing clause. I need not go on at length about this subject. ***You and your staff know what I'm talking about.***

And what did Mr. Conklin suggest as the solution to this particular problem? He wrote, "Instead of decontrol on date of enactment...may we suggest...decontrol when a contract has expired by its own term or five years after date of enactment, whichever comes first."

It is clear the decontrol legislation, H.R. 1722, which passed the House by a voice vote several weeks ago accommodates this concern of a large, politically important segment of the domestic producing industry. H.R. 1722, however, is not quite the legislation that every producer is happy with. There has been concern expressed, particularly by Ashland Oil, with the provision in the House bill which deregulates gas produced from wells spudded after March 23, 1989. Ashland, fearful that its high-priced tight sands gas would decline in price, wanted the spud date removed. As luck would have it, that particular offensive provision is absent from S. 783. This means that at least some very high-priced gas will not be decontrolled and will not fall to market levels. Clearly, S. 783 isn't an honest decontrol bill. It is a fraud in that respect. It is basically a bill that will allow low cost "old" gas to rise in price, and high-priced gas to remain at high levels.

Unhappiness with immediate decontrol or with an inconvenient spud date is not limited to gas producers. Certain large interstate pipelines, who carry a lot of weight inside INGAA and AGA, feared their economic interests would be adversely affected by immediate decontrol. Columbia Gas Systems, Inc., which once complained that immediate decontrol would add $250 million to its costs, helped convince certain lawmakers that a three year phaseout would not only be preferable, but would assure support from several other pipelines and would create a vehicle that INGAA and AGA could live with.

Then, of course, there are those like the American Public Gas Association, which represents municipal gas utilities, state consumer advocates, the Consumer Federation of America and ourselves -- all representing residential and small captive consumers who have concerns about this legislation and who have expressed these concerns to members of this committee. But our concerns are dismissed, because there is a consensus among producers, pipelines and large distribution companies. Our concerns about the FERC's final solution to the take-or-pay problem, our concerns about the contract problems, our concerns about distributor bypass and our concerns about access to pipeline transportation have been ignored.

Despite all of the rhetoric from supporters of the decontrol bills before this committee, these bills are not pro-consumer. Overall, natural gas prices will not fall, as some have suggested. On the contrary, given the recent developments in the gas market, we expect gas prices to rise. Phased decontrol will simply allow major producers to obtain higher prices for their "old" gas, while preserving higher for their "new" gas. Clearly, the fundamental reason that consumers oppose phased decontrol does absolutely nothing to help consumers. In fact it may end up hurting residential and other captive consumers because of the failure to address the serious problems that are emerging in the natural gas market.

Mr. Chairman, the decontrol bills before this Committee will not increase natural gas drilling, which is at record lows. It will not increase proved gas reserves, which are likely to decline again this year. It will not increase gas deliverability, which has continued to drop. It will not create more supplies in Canada, which are beginning to reach their maximum level. It certainly will not lead to lower prices, as some have argued, but may increase some prices. Moreover, the decontrol bills do nothing to rectify the growing segmentation of the gas market. They do nothing to correct the abominable and grossly unfair FERC ruling on take-or-pay passthrough. They do not force pipelines to become common carriers. They do nothing to restrict the growing problem of local distribution company bypass.

Increasing Concentration, Tightening Supplies and Price Fixing

The increasing concentration of ownership of gas reserves in both the U.S. and Canada in the hands of the largest oil and gas producers is a serious development in the gas market. Amoco's acquisition of Dome, Exxon's purchase of Texaco Canada, the purchase of Tenneco's reserves by Chevron and other large producers, and numerous other buy-outs and mergers will leave the major oil companies in a very powerful position when it comes to the nation's gas supplies. These companies are clearly anticipating that their new "emphasis" on natural gas will provide tremendous returns over the next few years.

States Mobil in its 1988 annual report,

> ...In North America, the outlook is improving as the supply tightens. Natural gas burns cleaner than other fossil fuels. So as environmental requirements stiffen, natural gas becomes a more attractive asset--one that may command a premium price in the future. Mobil should profit from these trends because of our large natural gas reserves.

Chevron's view is similar,

> ...The company forecasts an end to the U.S. gas surplus early in the 1990s, causing *gas prices to rise faster than crude oil prices for the rest of the decade.*

Sun Exploration and Production Co. (Oryx) agrees,

> ...In the intermediate term, we think that natural gas prices will rise, on a relative basis, more than oil prices.

Why these companies are so optimistic has as much to do with the intensive promotion of gas consumption by the industry as it does the ability of the major producers to set a floor under wellhead gas prices. We have already begun to see how a few large companies can influence the market during periods of slackening demand. By withholding supplies from the market a few large companies are setting a price floor of about $1.50 per Mcf. For example, it was recently reported that Conoco has curtailed about 10% of its producing capacity of about 800 MMcf/d at the end of February. And according to an ***Oil & Gas Journal*** survey of a representative group of producers, about 10-30% "of their estimated sustained productive capacity is curtailed because of low prices." As we enter warmer weather, don't be surprised if more and more companies shut-in production to keep prices from falling. This supply reducing activity is no different from OPEC efforts to agree on a quota to shore up prices. Yet, it seems some members of the Senate are more eager to reward producers than examine probable anti-competitive activity.

As major producers have increased their reserves through purchases rather than drilling (out of 32 companies surveyed thus far, purchases of reserves exceed reserves discovered through drilling), they have helped reduce proved reserves and gas deliverability (The AGA admits that by next year production capacity will have dropped from 20.5 Tcf in 1985 to 17.5 Tcf.). This has given rise to the recent analysis by John Sawhill in which he states, "Deliverability is declining so rapidly that it will be difficult to accommodate peak demand next winter, even assuming normal weather."

The American Gas Association likes to pooh-pooh this kind of analysis, because it interferes with its rose-colored Pollyanna image of abundant and available gas supplies which it likes to portray to potential gas consumers, especially large consumers like electric utilities. But even the Energy Information Administration's most recent study on gas demand by electric utilities cautions that "The resource base now generally believed to exist in the United States would not be able to handle such a massive demand for so long."

Others in the gas industry also point to the tightening supply situation. Palmer Moe, CEO of Valero Energy Corp. states "that spot shortages in peak demand periods will likely become increasingly severe and a regular occurrence."

Growing Demand, Higher Prices and Market Segmentation

Ken Lay, chairman of Enron and natural gas industry guru, says that an average wellhead price of $2.50-$3.00/Mcf is necessary if the gas industry is to surmount its most formidable long-term challenge, sufficient deliverability to satisfy projected demand growth. But how will producers get these prices? H.R. 1722 will help, because it in combination with the changes that have already taken place will provide major producers with complete freedom to influence the direction of the gas market.

With pipeline companies merging with each other and getting out of the production business and big producers buying up reserves and predicting that gas prices will rise faster than oil prices, one must conclude that there are plans afoot that are based on shifting costs from competitive markets to regulated markets. Listen again to Ken Lay quoted in his company's 1988 annual report,

> With supply and demand for natural gas basically in balance on an annualized basis, prices should begin trending upward, benefiting Enron's exploration and production business as well as its natural gas pipeline operations...For the longer term, Enron will continue to work at becoming less dependent on the weather and more committed to cogeneration and independent power markets where prices are not as weather sensitive.

This sounds like an example of market segmentation -- clearly the answer to the producers' problem of having gas prices linked to oil prices. The gas industry is working very hard to figure out ways to shift more and more fixed costs to residential and small commercial gas consumers -- the captive consumers who are prevented by local utility monopolies from participating directly in the marketplace.

Many local utilities want their state commissions to approve discriminatory rate structures, to force captive consumers to pay the preponderance of take-or-pay charges, to prevent captive consumers from obtaining access to transportation. Similar efforts are taking place at the FERC. The FERC has exempted transportation customers from take-or-pay liability. The FERC has allowed pipelines and large industrial customers to bypass local utilities. And the FERC is considering a proposal by the Process Gas Consumers to change the modified-fixed-variable pipeline rate design to an "Enhanced-Fixed-Variable" design. PGC, while admitting that the current design only requires transportation customers to pick up 1/3 of fixed costs -- return and taxes -- reflected in the commodity charge, wants the commission to place 50% of this in the demand charge. In addition PGC makes other proposals the purpose of which would shift additional fixed costs to the demand component. Of course, this proposal is touted as economically efficient. But how can it be efficient if residential consumers have so little choice when it comes to their gas supplier. This proposal, like many other cost shifting schemes, is nothing more than monopoly pricing being passed as "new economic thinking."

If the industrial users, distributors, pipelines and produces have their way, changes in FERC rules and decontrol will create two markets for natural gas -- competitive prices for large industrial users and monopoly prices for regulated users. Producers will obtain higher wellhead prices, because large local distribution companies will be faced with a handful of major oil companies in control of the bulk of gas supplies during a tightening market.

The Basic Problems With H.R. 1722 and S. 783

These bills are touted as a consumer bills. Rep. Sharp has written that "repeal of all remaining gas wellhead ceiling prices will probably now help U.S. gas consumers by giving them modestly lower prices." At the same time, however, a number of supporters of decontrol argue that passage of this legislation will lead to increased production thereby lowering "our growing dependence on foreign oil producers" and making more "clean-burning gas available for dealing with our environmental problems." First of all, this line of reasoning is contradictory. If this legislation leads to lower wellhead prices, then producers will even further reduce their drilling efforts and reduce production. With less production, ***less***, not more, gas will be available. With less gas production, ***more***, not less, oil will be imported.

However, assuming this legislation will lead to higher gas prices (which is what major gas producers certainly expect), then consumers will end up paying more. You just can't have it both ways!

In fact, H.R. 1722 and S. 783 will allow producers to continue to sell gas for prices at or above the market, because the legislation does not require immediate decontrol with contract renegotiation. As we have already noted, the IPAA members with gas currently receiving above-market prices will continue to collect these prices until their contracts expire or until January 1, 1993, whichever comes first. On the other hand, major gas producers, who own almost all of the remaining low-priced "old" gas, will obtain higher prices for this gas, but at the same time they will not have to sell significant quantities of higher-priced offshore gas {Sec. 102(d) gas} at market levels because of so-called "fail-safe" contract provisions which state "in no event shall the deregulation price be less than the price or prices provided for previously in the contract."

This legislation studiously avoids addressing the problems associated with take-or-pay and certain other provisions in producer/pipeline contracts. The FERC's decision to direct bill take-or-pay costs is forcing residential and other captive gas consumers to pay the lion's share of these costs. Transportation customers, with some exceptions, will escape payment for these costs, even though they were, in large part, responsible for creating many of the pipeline take-or-pay obligations as they shifted from gas to oil or from sales to transportation. Residential, commercial and other captive consumers were never given this opportunity and now will pay dearly. In some cases now before the FERC, pipelines are seeking to also pass through to consumers the take-or-pay costs they had previously agreed to absorb (viz Transco GIC proceeding). Because residential and other captive consumers do not have direct access to the competitive segments of the gas market, they are unable to avoid these charges. There is thus the irony that regulation, which is supposed to protect consumers from monopoly power, is being used to deny consumers the benefits available to unregulated entities.

Ironically, these very take-or-pay provisions appear to be of great concern to pipelines and distribution companies and their national trade associations -- AGA and INGAA. Both these organizations are part of a coalition which oppose the FERC's Order 451, otherwise known as administrative decontrol. In the joint brief to the U.S. Court of Appeals for the Fifth Circuit, the AGA and INGAA stated their opposition to the FERC's "failure to address the take-or-pay problem created by uneconomic producer-pipeline contracts covering the sale of high-priced new gas."

Also FERC Order 451 permits producers to obtain automatic abandonment of service, as long as they "execute a new sales agreement with a new purchaser and provide the former pipeline purchaser with at least 30 days notification of contract termination." H.R. 1722 allows producers of deregulated gas to abandon their service, which means that local distribution companies and their customers will be placed at risk. It is ironic, Mr. Chairman, that H.R. 1722 has the support of the AGA and INGAA when both these organizations opposed the abandonment section of Order 451. But, it seems these groups really don't care what happens to their gas supply and believe that they will have no problems lining up alternative supplies.

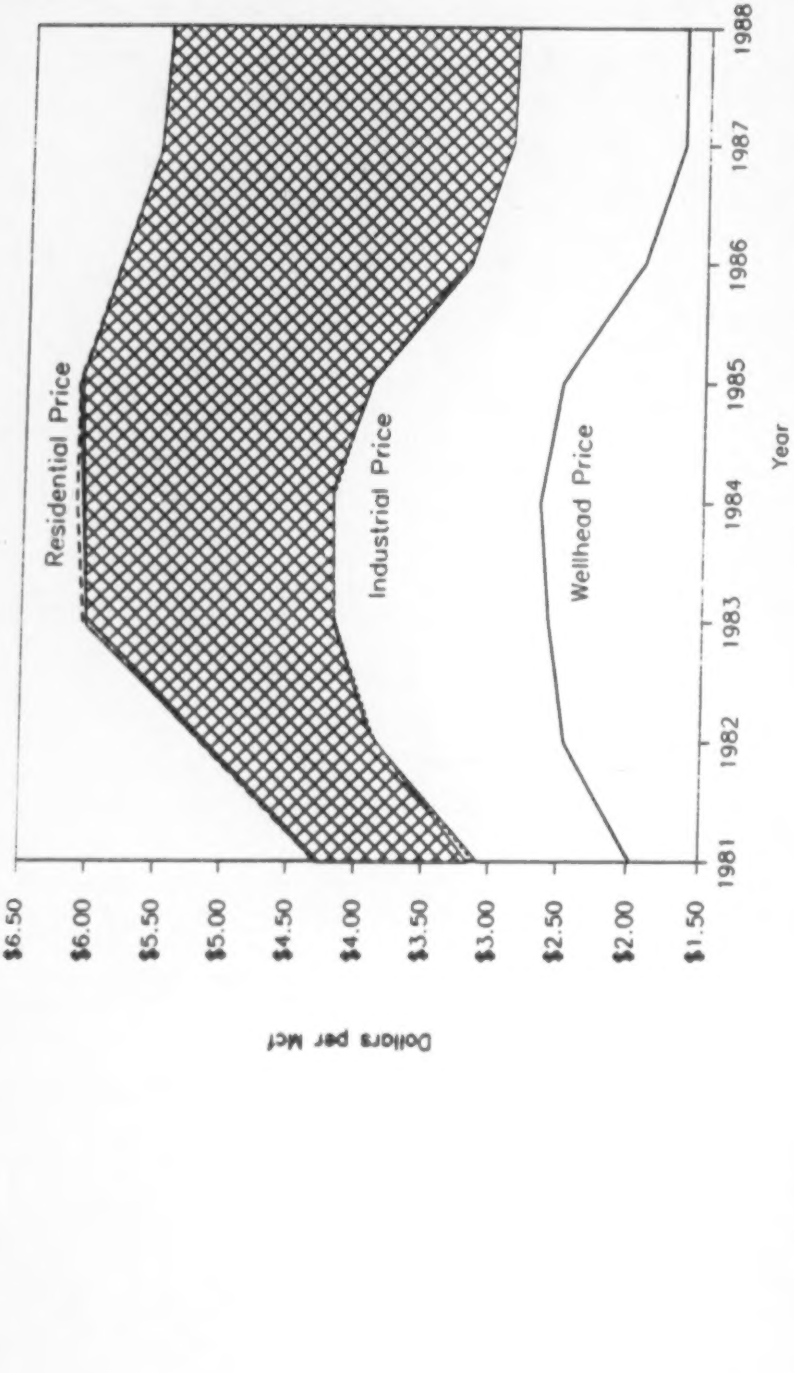
While we are on the topic of Order 451, Mr. Chairman, it is curious that S. 783 does not address this rulemaking. If either H.R. 1722 and S. 783 become law, and if the courts uphold the FERC, what impact will Order 451 have on legislated decontrol. Will producers still be able to operate under Order 451? Will they be able to utilize either approach? Clearly, these kinds of questions have not been answered. We recommend that the Committee, if it decides to adopt some form of decontrol legislation, specifically nullify FERC's Order 451.

Both H.R. 1722 and S. 783 are also silent on several other issues vital to residential and other captive consumers. These include local utility bypass and contract carriage. The FERC has arrogated to itself the authority to grant bypass petitions by interstate pipelines and large industrial consumers. When a bypass is approved, it means lower costs for the bypassing customer, but higher costs for all the remaining customers served by the local distribution company. This is unfair and an abuse of authority. Such authority rightfully belongs to the states, which must deal with the adverse impacts of bypass. Legislation, H.R. 540, to provide states with bypass authority has been introduced by Rep. Edward Markey. Unfortunately, this committee seems to lack interest in linking the producer-supported decontrol effort with consumer-supported bypass or take-or-pay initiatives.

Finally, decontrol of remaining ceiling prices is premised on the assumption of a consumer and producer access to pipeline transportation. Currently, that access is severely limited. If, as many are beginning to predict, gas supplies are no longer adequate to meet demand, pipelines may find it in their interest to cease their open access status. In that event, there would be nothing the FERC could do to force pipelines to transport gas on a competitive basis. Decontrol must be linked to a competitive transportation market, and legislation to decontrol must include provisions that give the FERC authority to mandate interstate pipeline transportation of gas. Without such a mandate both consumers and independent producers will be left holding a very expensive bag.

The Citizen/Labor Energy Coalition does not favor immediate decontrol, unless there is mandatory renegotiation of all contracts subject to decontrol, a fair resolution of the take-or-pay problem and a limit on the FERC's authority to grant petitions seeking bypass of local gas distribution companies and guaranteed access to both interruptible and firm pipeline transportation. Decontrol for producers must be linked with protection for captive consumers. We urge you to oppose any decontrol effort without legislative resolution of take-or-pay and bypass.

Natural Gas Prices 1981-1988



The CHAIRMAN. Thank you very much, Mr. Rothschild.

Mr. Lawrence.

STATEMENT OF GEORGE H. LAWRENCE, PRESIDENT, AMERICAN GAS ASSOCIATION

Mr. LAWRENCE. Residential prices have come down quite a bit, Mr. Chairman, and AGA strongly supports efforts to decontrol wellhead prices upon the expiration of contracts or renegotiation or January 1, 1993.

We appreciate the support that members of this Committee have given to wellhead decontrol. Were it not for the early introduction of S. 625 by Senator Nickles and Senator Ford, the industry-wide consensus would not have been developed in such a timely manner, and that is very important.

We previously testified in the House in support of H.R. 1722 and we are extremely pleased that the House passed that bill promptly. We are equally supportive of S. 783.

AGA is aware of the principal difference between the two bills, the spudded well provision, and we can support either position, as has been stated by others here today. And if you would like, in Q and Q I can expand on our position there.

But accordingly we hope the matter will be expeditiously resolved in conference. Now is the time to clear away the underbrush of remaining NGPA price ceilings.

I would emphasize that the bills before you do not delay decontrol until January 1, 1993. Decontrol proceeds in three stages: immediate decontrol for already expired contracts; continuing decontrol for expiring and renegotiated contracts; and the January 1, 1993, date merely picks up the remaining pieces.

At least one-third of flowing old gas will be deregulated the first year after enactment. We say at least because there will contracts that expired or are already expiring, and that will be increased by those which are renegotiated. And this amount increases each year as gas under expiring and renegotiated contracts is counted in.

January 1, 1993, finishes off a long process that started in 1978 with the passage of the NGPA. We believe this orderly decontrol will not raise consumer prices.

First, there is just not enough old gas to substantially affect market prices. It amounts to less than 17 percent of interstate deliveries. And because of the effect of Order 451, on average it is already virtually at market prices.

Second, the most expensive gas flowing today is tied to above-market NGPA ceiling prices currently in the five dollar range. Gas flowing today under these contracts averages in the three dollar range, which is still more than a dollar above market.

It is less than that five dollar ceiling because of renegotiation that has taken place. There is about ten percent of interstate sales in these above-market categories today. By 1993 we estimate that expiring contracts and natural depletion will bring this down to at most five percent, and we say at most because some portion of this gas will be renegotiated.

To the extent that there is any of it left, in January 1993 it will come down as a result of this legislation.

So we think the combined effect of these relatively small volumes of gas that will go down to market and will come up to market will just about offset each other.

I would like to take this opportunity to mention that we hear a lot of gloom and doomers on long-term supply, and they are having a tough time lately. The preliminary data indicate the reserve additions in 1988, even with this abominably low rig count of between 750 and 800, will be somewhere in the range of 90 to 105 percent of replacing production.

This strong performance reflects the shift toward gas-prone drilling, as opposed to oil-prone drilling, as well as a higher quality of drilling activities, improved exploration, formation evaluation techniques. In addition, coal bed methane emerged as an important source of reserve additions, about 940 BCF. That is five to six percent. That is not bad for something a few years back was a mine safety problem.

Plus there were new fields discovered or confirmed in the lower 48 states—again, bad news for the gloom and doomers on long-term supply of natural gas.

With this abundant supply base, we should recognize the important role that natural gas has to play in cleaning up our environment and reducing oil imports. Natural gas is the most easily implemented clean air compliance strategy. It can reduce acid rain, ozone, and carbon monoxide problems in a cost effective manner.

It can also play a key role in backing out imported oil, which in turn reduces the nation's trade deficit and improves our national security.

These national priority benefits will be enhanced with the passage of S. 783. Thank you.

[The prepared statement of Mr. Lawrence follows:]

TESTIMONY OF GEORGE H. LAWRENCE
PRESIDENT
AMERICAN GAS ASSOCIATION
BEFORE THE COMMITTEE ON
ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE
ON THE
DECONTROL OF
WELLHEAD PRICES

May 8, 1989

The American Gas Association (A.G.A). strongly supports the bi-partisan efforts to decontrol the wellhead price of natural gas upon the earlier of contract expiration; renegotiation; or January 1, 1993. These bills include, of course, S. 783, introduced by Senators Johnston (D-LA) and McClure (R-ID), as well as S. 625, introduced by Senators Nickles (R-OK) and Ford (D-KY). We also supported H.R. 1722 (originally H.R. 1595) in previous testimony before the House Energy and Power Subcommittee. The goal of all of these bills is the same -- to complete, at last, the transition to a decontrolled wellhead market that started in 1978.

A.G.A. appreciates the strong support that members of this Committee have given to wellhead decontrol. Were it not for the early introduction of S. 625, an industry-wide consensus on decontrol might not have developed as promptly as it did. A.G.A. also views the introduction of S. 783 as a clear sign that many on this Committee favor prompt action on decontrol. A.G.A. supports this goal.

A.G.A. previously testified in support of H.R. 1722, and we are extremely pleased that it passed the House on Monday, April 17, 1989. We are equally supportive of S. 783, and hope for its timely passage by the Senate. A.G.A. is quite aware of the principal distinction between the two bills. The House bill would decontrol the price of gas from wells "spudded" or begun after March 23, 1989, which is the date that the bill was introduced in the House. S. 723 does not have a comparable provision and thus treats gas from newly spudded wells no differently from other categories of gas. A.G.A. is pleased to say that, in general, neither position on this issue poses a problem for our membership. Accordingly, we hope the matter will be expeditiously resolved in conference.

For the first time, the 101st Congress has a bipartisan compromise on wellhead decontrol before it. This compromise has already won the support of local distribution companies, pipelines, and the major and independent gas producers. Now is the time to clear away the underbrush of remaining NGPA price ceilings. A.G.A. looks forward to this Committee's action on decontrol and the timely enactment of a consensus natural gas decontrol bill into law.

Now I would like to address some misconceptions about these bills.

Will This Legislation Raise Consumer Prices? No.

None of the bills before this Committee will materially affect the average price of flowing gas or consumer costs. In the years since the passage of the Natural Gas Policy Act, a very competitive commodity market for natural gas has developed. A number of factors have contributed to the development of this healthy competition: transportation services after FERC Orders 380 and 436/500; pressure from alternative fuel sources; and, increasingly sophisticated gas buyers, who facilitated gas-to-gas competition. Therefore, the price of flowing gas today is dictated by market conditions and contractual obligations, not by wellhead price regulation.

In 1988, the average price paid for gas was $1.71/Mcf. Only so-called old gas, in NGPA categories 104 and 106(a), has ceiling prices below this market-set price. Simply examining the relatively small volumes of this gas in the supply mix confirms our hypothesis that ceiling prices are not constraining gas prices. Through November of 1988, the Energy Information Administration (E.I.A.) reported 14.6 Trillion Cubic Feet (Tcf) of gas delivered to consumers, of which only 3.8 Tcf was purchased by interstate pipelines.1/ The remainder is being purchased directly by local distribution companies and end users at market-determined prices and transported by pipelines (See: Volume Chart). Old gas was an even smaller fraction of the supply mix, accounting for less than 1.8 Tcf of 1988 pipeline purchases -- and only 17% of total interstate deliveries.[2/]

In addition, average old gas prices are already very close to average market prices. This is in part due to: price declines for unregulated gas sales; mandatory inflation adjustments for old gas ceiling prices; and FERC Order 451, which potentially raises the price of old gas to market levels.[3/] Because of these factors, by 1988 the average price paid for old gas was $1.48/Mcf, compared to an average price paid for all gas of $1.71/Mcf. Given the relatively small volumes involved (compared to total deliveries) and the small difference between average old gas prices and the somewhat higher average market price, raising the price of NGPA Section 104 and 106(a) gas to market levels would represent a de minimus price change (See: Price Chart).

At the same time, all other NGPA categories, notably Section 102(d), have ceiling prices above the market price. To the extent that contracts allow, these prices may come down. In 1988, NGPA Section 102(d) gas represented roughly 470 Billion Cubic Feet (Bcf) of pipeline purchases, at an average price of approximately $2.65/Mcf.[4/] Downward movement in the price of this gas will be limited by contract pricing clauses, but somewhat lower prices can be expected. Such downward movement would be an offset to any upward price pressure, in the event of somewhat higher old gas prices.

It is important to remember, however, that the majority of gas flowing is responding to market pressures and will continue to do so. Small changess in the price of regulated gas will be overwhelmed by price changes for the much larger volumes of gas that respond to market forces. This is as it should be. The competitive market for gas is the best insurance that customers will receive supply to meet their needs at fair prices.

Enacting a decontrol bill at this time should not effect average commodity prices. A.G.A. was concerned, however, about the possibility of recreating the take-or-pay liability problem under existing old gas contracts. This bill addresses these concerns in an effective manner, as discussed below.

Does This Legislation Take Existing Contracts Into Account? Yes, but without abrogating or legislatively changing any contract.

Last Fall, A.G.A. began evaluating the effect of decontrol on existing gas contracts. During this data search and analysis, A.G.A. learned from several pipelines that contracts covering old gas often have price redetermination clauses that, upon decontrol, would require prices above market levels.[5/]

Fortunately, our data also showed that, because of the advanced age of these contracts, many of them would expire within 3 to 5 years. When that happens, this problem of higher prices because of contract provisions will virtually disappear. One of the reasons we support the legislation now before this Committee is that the final decontrol date, January 1, 1993, comes at a time when many of these contracts will have expired. Even for those contracts that will not have expired, January 1, 1993 gives pipelines and producers an adequate opportunity to renegotiate those contracts.

For many contracts, however, decontrol will take place much sooner. For example, in the first year after its enactment, perhaps as much as one-third of old gas would be deregulated because of already expired or expiring contracts. In addition, we would expect producers and pipelines to continue to renegotiate contracts during this time, deregulating more gas. Lastly, FERC Order 451 gives producers an option to get a deregulated price for very low cost old gas immediately.

As to unexpired and re-negotiated contracts, A.G.A. found that total and immediate decontrol, upon the date of enactment, did result in above-market contract prices and, consequently an increase in contract liabilities. But, extending the decontrol date -- by just 3 to 5 years --

ameliorated price increases under these contracts. (See: Table A)

A.G.A. commissioned the consulting firm, Foster Associates, to examine deregulation clauses in a sample of contracts for NGPA Sections 104 and 106 gas. The Foster results show that:

a) In 1989, interstate pipelines are likely to purchase an estimated 1.2 Tcf of old gas (approximately 20 percent of total interstate purchases).

b) About 56 percent of old gas contracts have a decontrol provision and a Most Favored Nation (MFN) clause, but have no clause to ensure market-responsive pricing (market-out clause).

c) Foster Associates examined total field purchases by area to calculate the existing marker prices for MFNs. Their analysis showed that most supply areas had a contract(s) with purchase prices in excess of $4/MMBtu, which could act as price markers for MFN clauses in other contracts. Therefore, old gas under the contracts mentioned in b above, which is currently selling at an average price of $1.86/MMBtu, would be eligible for $4/MMBtu or more upon decontrol. Gas priced at $4/MMBtu is clearly unmarketable under current conditions and would result in take-or-pay accrual.

d). In 1989, contracts for more than 400 Bcf of gas sales would be made unmarketable by immediate decontrol (See: Table A).

e) Using the conservative estimate of $4/MMBtu for the MFN marker, the 1989 potential new exposure resulting from immediate decontrol could reach $1.6 billion.

  - By 1993, the potential annual accrual would decline to $748 million. Renegotiation of contracts before 1993 could reduce this total still further.

The Foster data is persuasive evidence that, even though total and immediate decontrol appears to solve many wellhead pricing problems, it actually creates other problems. There are real costs associated with total and immediate decontrol that have to be taken into account.

The bills, as proposed, address these costs and create the framework for decontrol to begin upon enactment. Under this legislation, decontrol proceeds in three stages: (1) immediate decontrol for expired contracts; (2) phased decontrol for expiring and renegotiated contracts; and (3) the January 1, 1993 date that merely picks up the remaining pieces.

What Are the Benefits of Wellhead Decontrol? More Efficient Wellhead Markets and Production Decisions.

The multiplicity of NGPA pricing categories and the disparity between the lowest and highest ceiling prices (See: Table B), confuses producers' decisions on where and how to invest in exploration, drilling, and production. Instead of basing these decisions primarily on geologic and economic criteria, producers must also take a complicated federal pricing formula into account.

Decontrol would remove any lingering uncertainty about enhanced gas recovery projects in old fields. For example, Dr. Bill Fisher, a respected geologist and director of the University of Texas' Bureau of Economic Geology, suggests that as much as 119 Tcf of gas remains in old reservoirs. These reservoirs could be tapped at relatively low cost through infill drilling.

The DOE study, An Assessment of the Natural Gas Resource Base of the United States (May 1988), estimated that 800 Tcf of conventional gas is technically recoverable, with 495 Tcf of this produced at a price less than $3/Mcf, and another 116 Tcf at a price between $3/Mcf and $5/Mcf.

CONCLUSION

The decontrol legislation now before the Energy and Natural Resources Committee will enable all three segments of the natural gas industry to better go about their business of serving customers in a less regulated, more competitive energy market. Decontrol will come at a good time -- as the nation's vast natural gas resource base, and its extensive delivery system, make more and more important contributions toward achieving national economic, environmental and energy security priorities.

FOOTNOTES

[1] Natural Gas Monthly, DOE/EIA 0130 December 1988. Of the 16.2 Tcf of total gas consumption, 14.6 Tcf was delivered to consumers (the difference is primarily due to lease and plant fuel). Of this, A.G.A. estimates that 3.9 Tcf was consumed in the intrastate market, leaving roughly 10.7 Tcf for interstate deliveries to consumers. E.I.A. also reported interstate pipeline purchases of only 3.8 Tcf in 1988, or 35% of total deliveries. Thus, 65% of deliveries are purchased directly by LDCs and end users, at market prices, and transported by the pipeline.

[2] Ibid.

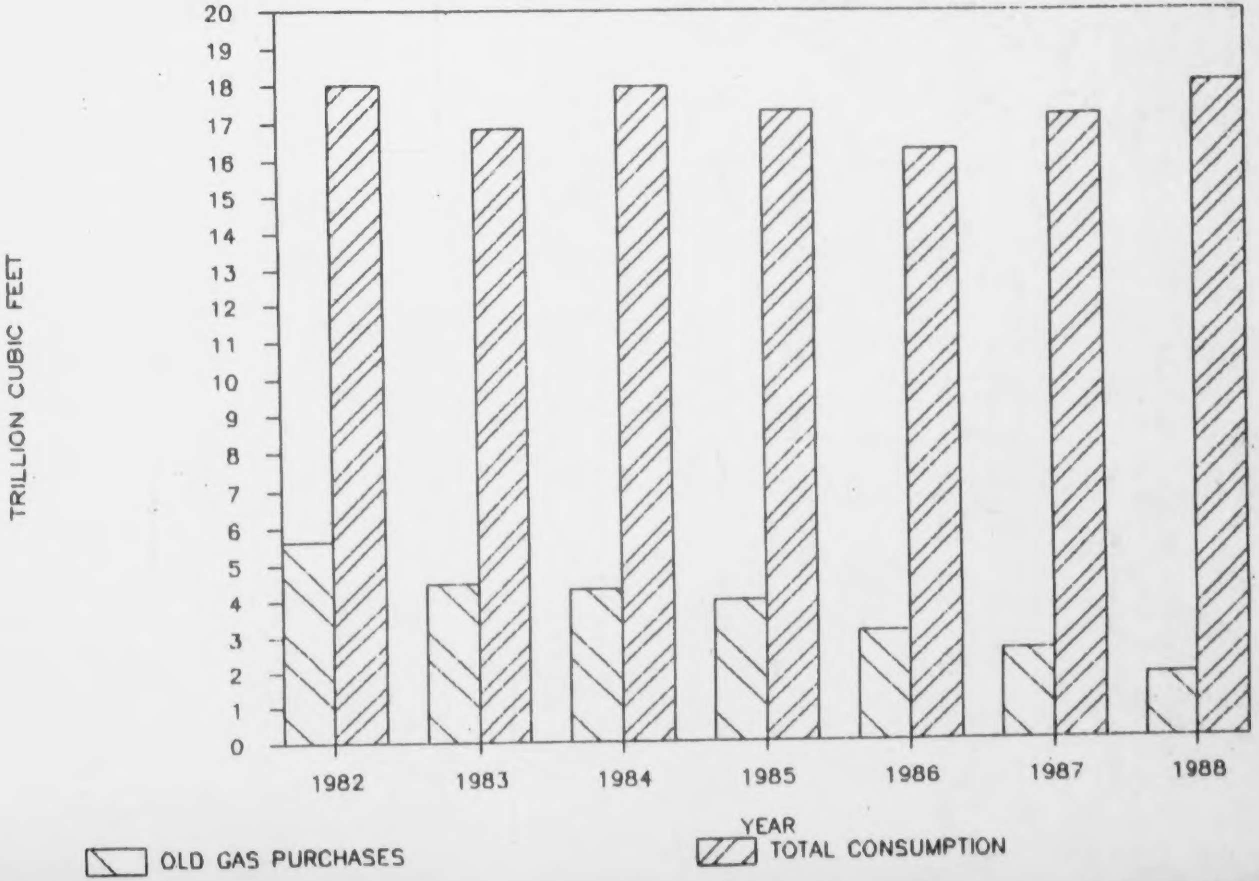
[3] III F.E.R.C. Stats. & Reg. para. 30,701, 51 Fed. Reg. 2,168 (1986). FERC Order 451 allows producers to initiate renegotiation procedures on any contract that includes some old, NGPA Section 104 gas.

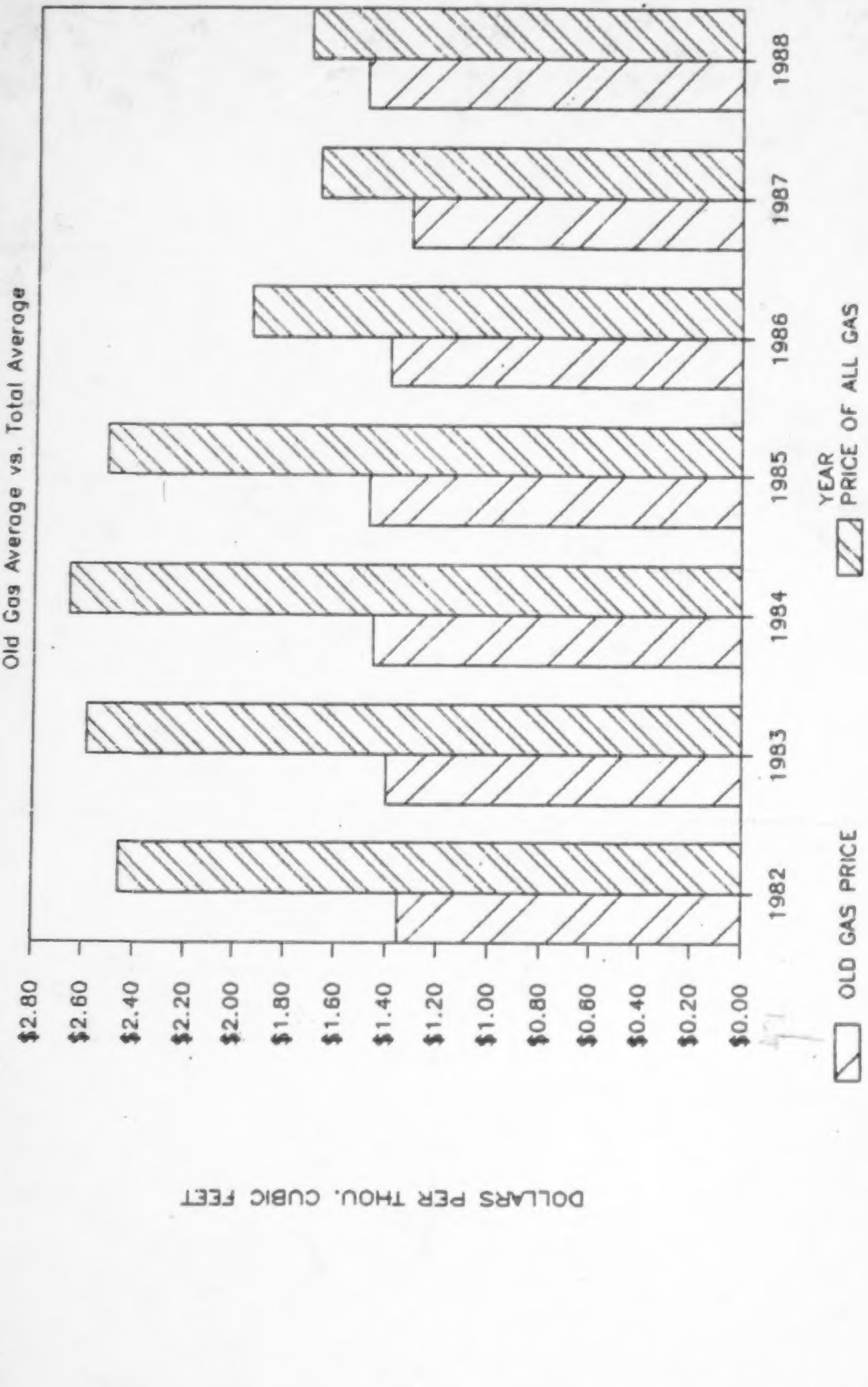
[4] Gas Costs, Resale and Transportation Rates of Pipeline Companies; PGA Monthly Service, Foster Associates, Inc., Washington, D.C., February 22, 1989 Transmittal.

[5] The most common provision sets the price at the average of the two or three highest prices being paid in the relevant producing area. These provisions are commonly referred to as "most-favored-nation" (MFN) provisions.

NATURAL GAS MARKET VOLUMES

Old Gas Purchases vs. Total Consumption





AVERAGE WELLHEAD GAS PRICES

Old Gas Average vs. Total Average

TABLE A

Projected Old Gas Volumes Under Current Contract Production and Reserves (BCF)

Year of Production	1989	1990	1991	1992	1993	1994
Total Production of Old Gas	729	553	499	417	334	305
Old Gas Reserves Underlying Contract	7,184	5,881	5,381	4,744	3,649	3,305
Old Gas Production with Favored Nations and No Market Out	408	310	279	233	187	168
Potential (New) Annual Exposure of the Contract at $4.00/MCF (in millions of dollars)	$1,632	$1,240	$1,116	$932	$748	$672
Cost Differential with $2.00/MCF Gas (in millions of dollars)	$816	$620	$558	$466	$374	$336

TABLE B
NATURAL GAS CELING PRICES (OTHER THAN NGPA SECTOINS 104 AND 106(a)

Subpart of Part 271	NGPA section	Category of gas	Maximum lawful price per MMBtu for deliveries in April 1989
B	102	New Natural Gas, Certain OCS Gas	$5.239
C	103(b)(1)	New Onshore Production Wells	3.412
E	105(B)(3)	Intrastate Existing Contracts	5.034
F	106(b)1(B)	Alternative Maximum Lawful Price for Certain Intrastate Rollover Gas	1.951
G	107(c)(5)	Gas Produced from Tight Formations	6.824
H	108	Stripper Gas	5.609
I	109	Not Otherwise Covered	2.824

NATURAL GAS CEILING PRICES: NGPA SECTIONS 104 AND 106(a) (SUBPART D, PART 271)

Category of Natural Gas	Type of Sale or Contract	Maximum lawful price per MMBtu for deliveries made in April 1989
Post-1974 gas	All Producers	$2.824
1973-1974 Biennium gas	Small Producer	2.384
	Large producer	1.825
Interstate Rollover gas	All producers	1.048
Replacement contract gas or recompletion gas	Small producer	1.340
	Large producer	1.027
Flowing gas	Small producer	0.677
	Large producer	0.571
Certain Permian Basin gas	Small producer	0.799
	Large producer	0.706
Certain Rocky Mountain gas	Small producer	0.799
	Large producer	0.677
Certain Appalachian basin gas	North subarea contracts dated after 10-7-69	0.643

The **Chairman**. Thank you very much, Mr. Lawrence.

Mr. Gooch.

STATEMENT OF GORDON GOOCH, GENERAL COUNSEL, PETROCHEMICAL ENERGY GROUP

Mr. **Gooch**. Thank you, Mr. Chairman. I apologize for a cold.

It is my honor to be here to present the views of the AISI, the CMA, the National Association of Manufacturers, the Chamber of Commerce, and the Petrochemical Energy Group. All of these industrials, which we do identify as consumers of natural gas, would be very pleased if any one of the bills before you were passed.

Contrary to some others, we believe that deregulation is in the best interests of all gas consumers. We believe that any system of administered prices will always come in far inferior to a system that does not depend on some regulator's guess as to how to set the price and what supply will be elicited at each price level.

Some evidence of that, I think persuasive evidence that it makes a difference, comes from the fact that the industrial market is of course the one that you have to look to in large measure to make that market, and make it, I think it is fair to say, we have.

If you just compare 1983 with 1987 and use the EIA numbers, it appears that the savings in just the purchased gas component alone for all consumers in the year 1987 as compared to 1983 was $4.9 billion reduction at the wellhead. And the interesting thing about the EIA numbers is they found that the price controlled gas was being maintained at above market-clearing levels to the tune of about another $614 million.

So there was a subsidy, if you will, of an additional $614 million for all consumers nationwide as a result of the maintaining of the price controls.

Now, in all fairness, when you look at it from the consumers' standpoint there are two components to the costs that you pay. One is at the wellhead, the other is in the middlemen, the middlemen being the pipelines and the distributors.

I am not here to make any complaint about that, but I do think that most of the complaints that Mr. Rothschild has have nothing to do with the wellhead price; it has to do with the way the costs are allocated, particularly at the local distribution company level.

But if you look at the statistics in 1988, you see that about half the cost to the consumer on average is at the wellhead and the other half is from the middlemen.

Now, people talk about how the industrials shouldn't participate in the transportation market. We help in two ways, because I do not care how you want to fry the old egg in rate regulation; the plain truth is the formula is costs divided by volume.

So the more gas that is transported, the lower the costs for the middlemen, whether it is Mr. Lay's pipelines or Mr. Lawrence's LDC's. The more gas that is transported, the lower the cost is going to be for all consumers at the middleman level, as well as making the market at the wellhead level.

Now, the newly spudded well issue, for example, either way, anything you want to do. That just cannot be that big a problem pragmatically. There is theological problems and undoubtedly some companies care, but pragmatically it can make—no difference that it would make in any way should affect the outcome of this litigation.

The CHAIRMAN. You mean the date on the newly spudded wells?

Mr. GOOCH. Any way you want to slice it. Any way, it is just not that big a deal. If you look at the numbers and what the potential impact would be, it just is de minimis.

Now, I do want to say something about the bypass issue just briefly. Some people make it seem like bypass is a brand-new issue. Bypass has been in the Natural Gas Act since 1938. It started out as direct sales by the interstate pipelines directly to industrial consumers, sanctioned by the Congress.

Well, it ought to cheer people up to know that between 1984 and 1988 the amount of gas going from direct sales from interstate pipelines to industrial consumers is down by 60 percent. And the bypass issue, whether it is a 311 or a certificated one, the big problem is people do not like the Commission giving expedition to what is clearly part of the Natural Gas Act and which you added in the NGPA.

So we would like to suggest that we will take and urge, if you will, if you will please pass any one of these bills.

[The prepared statement of Mr. Gooch follows:]

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TESTIMONY ON BEHALF OF THE PETROCHEMICAL ENERGY GROUP

Committee on Energy and Natural Resources
United States Senate

May 8, 1989

Washington, D.C.

TESTIMONY OF THE
PETROCHEMICAL ENERGY GROUP
MAY 8, 1989

I. INTRODUCTION: INDUSTRIAL SUPPORT FOR DEREGULATION.

My name is Gordon Gooch. I appear today as the General Counsel of the Petrochemical Energy Group in response to the letter of April 21, 1989 from the Honorable J. Bennett Johnston, Chairman of this Committee. I am authorized to state that my testimony today is generally supported by the American Iron and Steel Institute, the Chemical Manufacturers Association, the National Association of Manufacturers and the U.S. Chamber of Commerce. A description of each of these groups is attached as Appendix 1. For convenience, I will refer to us all as "industrial users" of natural gas.

Industrial users, as a class, have historically advocated the termination of federal price and allocation controls over the wellhead sales of natural gas. We do so again today.

By "federal price and allocation controls" we intend to capture two distinct forms of regulation. "Price controls" refers to maximum lawful prices whether set by the Congress under the Natural Gas Policy Act ("NGPA") or by the FERC. "Allocation controls" refers to the non-price control aspects of federal regulation, not the least of which is the requirement that a sale for resale in interstate commerce subject to the Natural Gas Act cannot be terminated without the permission of the FERC, called an abandonment, even when the underlying contract expires by its own terms.

Energy Information Administration ("EIA") data for 1987 indicate that approximately 65% of the natural gas purchased by the twenty major interstate pipeline companies was subject to federal price controls and somewhat less than that percentage was subject to federal allocation controls. 1/ This percentage does not take into consideration whether the contract price may have been less than the maximum lawful price ceilings.

1/ Energy Information Administration, Wellhead Purchases by Interstate Natural Gas Pipeline Companies Since the NGPA -- Trends and Profiles (1988) at 20, Table 7 [hereinafter cited as Wellhead Purchases].

II. SUMMARY: ANY OF THE THREE BILLS SHOULD BE PASSED.

We have been asked to review three bills -- S. 783, S. 625, and H.R. 1722. In general, the three bills have three essential common characteristics:

(1) Each provides for the termination of federal price and allocation controls pursuant to the Natural Gas Policy Act and Natural Gas Act on the wellhead sales of natural gas on a common date certain.

(2) Each provides for certain specified earlier termination of federal price and allocation controls on the wellhead sales of natural gas.

(3) None of the bills address issues beyond the scope of the termination of federal price and allocation controls on the wellhead sales of natural gas.

Having analyzed these bills, we respectfully recommend that any one of them be passed.

We recognize that there are differences among the three with respect to the second element, and we acknowledge that preferences for certain provisions in different bills exist. But we waive any preferences in order to facilitate the ultimate achievement of the deregulation of natural gas sales at the wellhead without addressing extraneous matters. This ultimate goal so far outweighs any interim benefit or detriment that we regard it to be our duty to sublimate any special interest pleading. Indeed, in order to achieve this ultimate goal, we even refrain from calling for the complete decontrol of natural gas on date of enactment.

III. DEREGULATION IS IN THE BEST INTERESTS OF CONSUMERS.

Deregulation of natural gas sales at the wellhead may not be in the best interests of all segments of the natural gas industry, but it certainly is in the best interests of the consumers of natural gas and natural gas liquids. While the largest consumer group in this country is the industrial consumer, 2/ we believe that deregulation also benefits the residential, the commercial, and the electric utility sectors.

The reason that we suggest that deregulation is in the best interests of all gas consumers is our belief that

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2/ Energy Information Administration, Natural Gas Monthly (January 1989) at 8, Table 3 [hereinafter cited as Natural Gas Monthly].

market forces offer the best hope of achieving a reliable supply of natural gas at a reasonable cost, a far superior alternative to either totally or partially administered prices.

This belief is bolstered by the history of natural gas pricing since the NGPA. To illustrate, please consider data published by the EIA in 1988, showing the declining trend in average gas prices, notwithstanding the multiple categories of gas under the NGPA. 3/ We believe that it is fair to assert that one of the material causes, among others, of the decline in average prices -- a decline of some 33% from 1983 to 1987, or $1.04 on average -- was competition, both interfuel and gas-on-gas. While there are significant industrial uses of gas, such as feedstock, process, plant protection, and safety stabilization of coal burning, for which there are no realistic substitutes, the industrial market still provides a significant elastic demand that can be relied upon to affect the price of gas for all consumers.

If all price controls are viewed as a form of administered consumer protection, it is somewhat ironic that the EIA would find:

> Perhaps the most important finding about new-gas purchases is that the categories still subject to price controls have retained the highest average wellhead prices. . . . 4/

Indeed, the EIA projected that,

> [i]f all price-controlled gas projected for purchase in 1987 were to fall in price to the average level of other (decontrolled) new-gas prices -- themselves still somewhat above spot market levels -- the result would be a decrease of $0.13 per thousand cubic feet (about 6 percent) in average prices of interstate wellhead purchases. 5/

While the average price of gas sold to interstate pipelines may or may not decline further upon decontrol, we

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3/ Wellhead Purchases, supra note 1, at 26, Table 8.

4/ Id. at 23.

5/ Id.

do not wish to be considered solely as supporters of decontrol for a selfish interest in lowering gas prices. We fully recognize that supply is the other side of the equation, and that adequate economic incentives must be available in order to insure a long term, reliable gas supply at a reasonable cost.

Some may also overlook that natural gas is also a principal source for natural gas liquids, such as ethane, propane, butane, and other hydrocarbons that not only have use as fuels but also are the vital feedstocks for the petrochemical industry in this country, as is natural gas itself. From these hydrocarbons comes the fertilizers, the plastics, the man-made fibers, the paints and coatings, the medicines, and a host of industrial, agricultural, and domestic products essential to our economy.

We do not wish to return to curtailments, as in the Seventies. Administered prices did not prevent the slide into curtailments. In fairness, the compromises that resulted in the NGPA, including partial decontrol, as well as the "incentive" categories of natural gas, operated to turn around the gas supply situation. Now that the NGPA can fairly be said by all to have achieved this purpose, whether to the satisfaction of all concerned or not, it is time to complete the process and terminate federal price and allocation controls over the wellhead sales.

Nor do we wish to leave the impression that the level of wellhead costs is the only concern with respect to reasonable prices. Using the EIA data of 1987 6/ as an illustration, the following statistics are enlightening:

Average price paid for imported gas	$2.14
Average price paid for gas purchased from producers	$2.12
Average price paid to interstate pipelines by gas distributors	$2.87
Average price billed to all consumers	$4.05

6/ *Natural Gas Monthly*, *supra* note 2, at 10, Table 4.

For comparative purposes, the same data for 1984, 7/ the earliest year shown with complete data lines:

Average price paid for imported gas	$4.08
Average price paid for gas purchased from producers	$2.91
Average price paid to interstate pipelines by gas distributors	$3.95
Average price billed to all consumers	$4.85

While considerably more refinement and exposition of the EIA statistics would be required to present a complete description of the situation, even these summary numbers provide some insight into the margins which exist between the wellhead and the consumer. The margins are part of the cost of gas to consumers.

Rates and rate-making at the FERC and at the State Commissions provide some oversight of what would otherwise be near monopoly situations. No complaint is here expressed about this process, all such comments being reserved. The main purpose for displaying these numbers is to set the predicate for the proposition that deregulation of the wellhead price and allocation controls, coupled with the evolving efforts of the FERC to restore the transportation function to some parity with the gas merchant function of the interstate pipelines, as set forth in Section 1(b) of the Natural Gas Act in 1938, will further benefit consumers of all classes with respect to the rates paid to the middlemen, the pipelines and the distributors. That is because the higher the volume of throughput, the lower the unit commodity cost at the middleman level.

However complicated a so-called rate expert wants to make it, the plain truth is that the formula for rates is basically: costs divided by volumes. Usually, but not always, this is done in at least two sets, one set of costs and volumes relating to the right to capacity, the other set relating to the volumes of gas that will go through the delivery system and the related costs. While litigation abounds on how to calculate the costs, how to functionalize and classify the costs, how to allocate the costs, and how to design rates, the bottom line remains: the higher the volume, the lower the cost to the consumer.

7/ Id.

Thus, not only should competition at the wellhead provide the discipline of a market there, the resulting movement of gas, either by the pipeline as merchant or the pipeline as transporter -- whether the shipper is another interstate pipeline company, a local distribution company, an end user, or some marketer selling to any or all of the three types of customers -- should also favorably impact the rates paid by all consumers of gas to the middlemen.

IV. TECHNICAL, LEGAL, AND POLICY COMMENTS

In hopes of being both responsive and responsible, we do provide some analysis and commentary on some of the provisions contained in the bills. In doing so, we intend no objection to any bill, as is. We hope that our comments will be useful to the respective sponsors and those who are considering the bills in deciding the ultimate formulation.

A. "Newly Spudded Wells"

One of the salient differences between the bills is the "newly spudded well" issue. Frankly, we do not view this as a major difference sufficient to kill the chances for a bill. As consumers of gas we do not anticipate that the outcome of this debate will have any significant impact that would negate the ultimate benefits of total decontrol. We fully appreciate that this is a divisive issue, and we trust that an acceptable resolution can be reached. We hope to contribute to the resolution by saying "either way or anywhere in between."

Our inquiries have led us to believe that those who do not wish immediate deregulation of newly spudded wells include those who fear that the price of gas from these wells would go down from regulated to deregulated pricing levels. In addition, there is apparently some concern about the potential impact on certain tax credits relating to coal seam methane and tight sands gas.

While we will defer to others to quantify the magnitude of this particular debate, we cannot help but note that:

(1) if the debate centers around stripper well gas, that category comprised about 4% of the total purchases of interstate pipelines in 1987. 8/

8/ Wellhead Purchases, supra note 1, at 20, Table 7.

(2) if the debate centers around "old" OCS gas, that category comprised about 11% of the total purchases of interstate pipelines in 1987. 9/

(3) if the debate centers around "tight sands" gas, that category comprised about 2% of the total purchases of interstate pipelines in 1987. 10/

(4) if the debate centers around new on-shore production wells, the EIA study herein relied upon does not permit a calculation that distinguishes between the regulated and the deregulated Section 103 gas, but the outside range, assuming the false conclusion that there is no deregulated Section 103 gas, is 9%. 11/

(5) if the debate centers around coal seam methane, we have been unable to locate comparable EIA data to the above. Perhaps "coal seam methane" is included, in whole or in part, under the EIA heading of "Other High Cost" gas. If so, it made up less than 1% of the total wellhead purchases in 1987. 12/

If these are the totals resulting from the NGPA process from 1978 to 1987, it seems unlikely that a few years one way or the other in production from the drilling of new wells in these categories would achieve a dramatic result for the nation as a whole. Certainly, on a scale basis, whatever happens, it cannot compare to the tragedy that would result from an impasse that kills the process.

B. Interim deregulation.

Another perceived difference between the bills, again not sufficient to cause the death of any bill, relates to the timing for decontrol for certain events prior to total decontrol. As perhaps an over-generalization, S. 625 provides somewhat more deregulation in the interim than do the other two bills, leaving aside the newly spudded well issue, although all contain some common elements, if correctly interpreted by us:

(1) All deregulate gas sold after contracts have expired or are terminated after date of enactment.

9/ Id.

10/ Id.

11/ Id.

12/ Id.

(2) All deregulate gas under contracts which are renegotiated after date of enactment, where there is mutual agreement to deregulate.

(3) All deregulate gas where the gas was not subject to a contract on date of enactment. This apparently would include gas subsequently sold under "new", "rollover", and "successor" contracts, as defined in the NGPA.

The differences appear to be:

(4) S. 625 would, in addition, deregulate gas under "new", "rollover", or "successor" contracts entered into after date of enactment, regardless of the contractual status on date of enactment, thereby broadening (3).

(5) S. 625 would, in addition, deregulate gas where the previous contract has expired, lapsed, or was terminated on or before date of enactment, thereby broadening (1).

On and after date of enactment, there is a potential for greater volumes of natural gas to be subjected to market forces under the S. 625 formulation than under the other two which require some form of conduct after date of enactment to trigger decontrol.

Again, we choose not to argue the merits of either formulation on this basic policy call.

V. CONCLUSION

In conclusion, we appreciate the opportunity to be heard on this historic legislation. We respectfully urge favorable action to terminate the remaining federal price and allocation controls on the wellhead sales of natural gas and that any such bill remain free of any provisions other than those relating to price and allocation controls on the wellhead sales of natural gas.

It would be tragic if this opportunity were lost.

Appendix 1

American Iron and Steel Institute (AISI)

AISI is the principal trade association of the domestic steel industry. Its 41 domestic members account for approximately 81% of the raw steel production in the United States. Members of AISI consume large quantities of natural gas in both process and non-process applications.

Chemical Manufacturers Association (CMA)

CMA is a non-profit trade association of 170 member companies. CMA's member companies represent more than 90% of the productive capacity of basic industrial chemicals in the United States. They use 25% of the industrial gas consumed in the United States and 10% of the total U.S. gas consumed.

National Association of Manufacturers (NAM)

NAM is a member-led association addressing the issues that challenge manufacturers. NAM has 13,500 member companies which operate thousands of manufacturing plants throughout the U.S. More than 8,000 of these companies are small manufacturers.

Petrochemical Energy Group (PEG)

PEG is an ad hoc group of independent petrochemical companies that use natural gas not only as boiler and process fuel but also as raw materials, or feedstocks, for the production of petrochemical products. The petrochemical industry has plants in all regions of the country. PEG companies purchase gas from local distributors, interstate pipelines, intrastate pipelines, and directly from producers.

U.S. Chamber of Commerce

The U.S. Chamber of Commerce is the world's largest federation of businesses, state and local chambers of commerce, and trade and professional associations.

The CHAIRMAN. Thank you very much, Mr. Gooch.

Mr. Liberman.

STATEMENT OF LEE M. LIBERMAN, CHAIRMAN AND PRESIDENT, LACLEDE GAS CO.

Mr. LIBERMAN. Thank you, Senator. I appreciate being here.

I am here in opposition to the bill. There are not very many like me here, I see.

I would like first to—and my testimony I am not going to read—but I would like first to review briefly my testimony, which really deals with history, not with predictions. I think the history of the Natural Gas Policy Act does not lead necessarily to the conclusions that some members of this Committee have reached.

First, that we must take account of the fact that natural gas costs are about to——

Senator CONRAD. Could you pull the microphone closer to you there.

Mr. LIBERMAN. First, we must take into account the fact that average natural gas prices in 1973 were about 20 cents. They started rising at 20 cents and continued to rise while the debate of the Natural Gas Policy Act continued.

In 1974 they went to 30 cents, the next year I think to 51 cents, 79 cents, up to 91 cents. At the time you debated this bill, the Natural Gas Policy Act, they were at 91 cents. They increased to $1.19 thereafter, and they kept going up until 1985.

On January 1st, 1985, you deregulated gas and you say, eureka, that ended the gas shortage. I propose to you that the gas shortages were ended long before that, because these increasing prices, part of which the FPC, later the FERC, took part in, increasing prices stimulated some of the activity to drill, it is true, and there was great activity in drilling. But what they really stimulated was a loss in demand. We lost a great deal of the market. We went from a market that served over 22 trillion cubic feet in 1973; we served about 17 trillion cubic feet last year.

So I think we can all look at history, but we can get different lessons out of history. If we look at the supply response of the natural gas reserves during the period that I am talking about, it was very dismal and very disappointing.

I am not a gloom and doomer, but I do look at the facts, and the facts are that we only replaced our gas reserves in one year of the whole period that I am talking about. And although Mr. Lawrence has new figures of gas supplies in 1988, he all of a sudden has those figures—the fact is he has never had them this early before—which say we got 17 trillion or so, 90 to 105 percent replacement. That is one of two years then that we replaced reserves.

Now, when you do not replace the reserves, you are not going to have adequate supply to do all these great things that natural gas is supposed to do.

If we look at the market, we can see the market went down. So my thesis is that we do not have the gas reserves. We may have enough gas underground to do all of these things, but we are not going to discover it at rapid enough rates to bring it into production to solve all these problems.

Now, let me talk about the future a little bit. Because I am not a predictor who is so great about what's going to happen in the future. I do not know what is going to happen to the price. We have some testimony that says, because so much of the gas is not controlled at a price—that it is controlled at a price that is below the market, when that decontrol comes off that price will go up and that will cause some increase. And we have other gas that is under high-priced contracts that apparently—and I do not understand this, but apparently—if decontrol occurs those prices can come back down to market.

But I think most of those prices may not be able to come down to market if they are contractual, unless the contract so provides.

But let us assume there is enough gas that comes out of control to offset the gas that is going down to market, so the immediate effect does not increase prices. If there are not generally increased prices, looking at supply we can say, first, that that is not going to encourage increased supply from decontrol, because to get more supply, more drilling, you have to have increased prices.

In addition to that, under the present setup, with almost all new drilling deregulated, we have enough incentive now to drill new gas wells. There is nothing about drilling new wells, except in a few areas, that prevents us from getting more gas supply.

So I say you are not going to elicit the gas supply that is necessary here. You are not going to elicit the gas supply, and because the production is not being replaced by new reserves being discovered, we are going to have a crunch on demand. We will have to suppress the demand.

The amount of natural gas reserves is now at the lowest level in the last 30 years, despite Mr. Lawrence and his rosy predictions. The natural gas reserves, that is the proved reserves in this country, are at its lowest level in about 30 years. They are about the level that they were in 1951 or 1952.

When this occurs, when the shortage of the reserves occurs, we will not be able to supply gas to all electric generating plants, we will not be able to supply gas to all the industrial boilers. We will have the residential captive consumer really demanding all the gas that is there.

Gas will be short, and when things get short prices will go up. That is what happens when things get short. And when prices start up, who is going to bear the brunt the residential consumer.

Now, the reason that I do not want you to repeal this bill is that this bill contains the last vestige of control to restrain that impact on the captive residential and commercial community, when those prices start going up. Sure there is no problem today where prices are relatively low but when the prices go up the control will become the thing that restrains the prices, and that is what I think we ought to be taking a look at right now.

Thank you.

[The prepared statement of Mr. Liberman follows:]

TESTIMONY OF

LEE M. LIBERMAN
CHAIRMAN AND PRESIDENT
LACLEDE GAS COMPANY
ST. LOUIS, MISSOURI

BEFORE THE SENATE COMMITTEE
ON ENERGY AND NATURAL RESOURCES

MAY 8, 1989
WASHINGTON, D.C.

Testimony of Lee M. Liberman

I am Chairman and President of Laclede Gas Company, a local distribution company (LDC), supplying natural gas to about 570,000 customers in the Missouri portion of the greater St. Louis Metropolitan Area and in portions of seven counties lying south of St. Louis.

I have a serious concern over the long term effects of the elimination of price controls on the first sales of natural gas by gas producers, as provided in H.R. 1722, recently passed by the House of Representatives. I believe the rationale for the House action is defective in that it rests on the premise that there is plenty of natural gas in the United States that can be readily discovered if the proper incentives are provided so that the shortages of the early 1970s will not recur. If this premise is false, as I certainly believe it to be, the case for decontrol becomes seriously vitiated.

Those who advocate decontrol have pointed out that "price controls" applicable to producers prior to the NGPA being enacted caused the shortages of natural gas in the early '70s by not providing adequate incentives for producers to explore for and discover new gas reserves. They say that the deregulation and increased prices permitted by the NGPA unshackled the producers and allowed the free marketplace to bring the market into equilibrium. They imply, if not explicitly so stating, that the supply of natural gas expanded to eliminate the shortages.

But even a cursory investigation shows this not to be true. I have attached hereto as Exhibit 1 a graph which relates new gas prices to the number of gas wells drilled in the United States in the period 1952-1987. Exploratory well drilling did surge emphatically to a record number after enactment of the NGPA and that fact would seem to lend credibility to those who claim an expansion of supply resulting from such enactment. The drilling of wells and the discovery of gas, however, are not necessarily linearly related. While you cannot discover gas without drilling, you can drill a lot of wells and still not discover much gas.

I attach hereto as Exhibit 2 a graph of the inventory of proved gas reserves existing during the period 1947-1987 and Exhibits 3 and 4, which relate new gas prices and production to reserve additions. The conclusion is inescapable that despite the higher prices permitted by the NGPA and the increased drilling activity, reserve discoveries were disappointing. In only one year after the passage of the NGPA did the amount of gas discovered slightly exceed the amount of gas used. Thus, higher prices and reserve discoveries resulting therefrom cannot be said to have played any important role in eliminating or easing the shortages. The truth is that our experience since the passage of the NGPA can only lead to the conclusion that there is a resource difficulty with respect to natural gas and that gas supplies during this period indicated an extreme price inelasticity. If I am right about this, then easing price controls is not the key to unlocking the vast quantities of gas reserves that will be required to do the things envisioned by the proponents of H.R. 1722, namely providing cleaner air, lowering oil imports, enhancing energy security and helping lower the deficit by moving the U.S. increasingly towards an abundant domestic fuel. I think a policy based on relying on natural gas to do these things is ill advised because there is no evidence that an adequate resource base really exists or that if it does exist that it can be brought into production at prices low enough to fuel the substantial growth in demand envisioned.

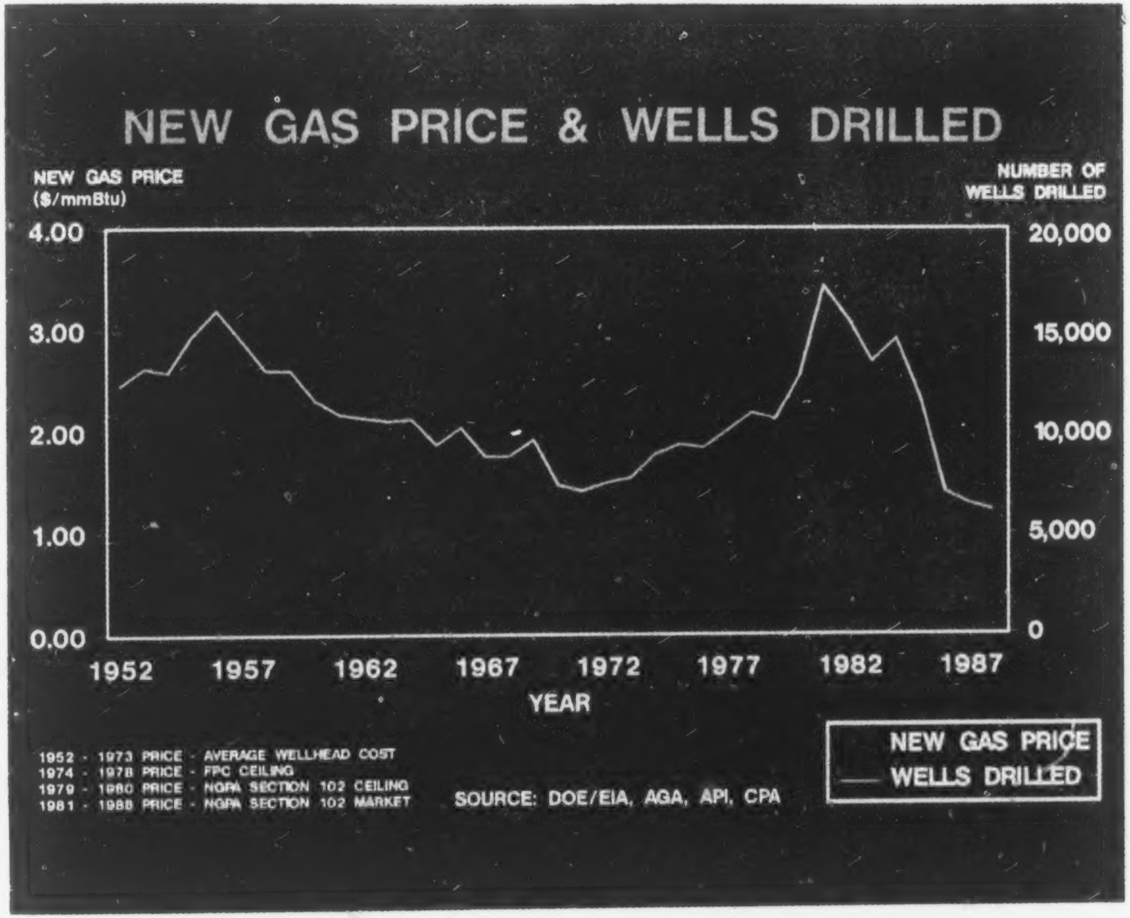
If price didn't eliminate the shortages of the early '70s, how did the shortages get eliminated? The answer lies not in the growth of supply, which I contend is relatively inelastic, but in the lowering of demand which is, or at least was in the period following enactment of the NGPA, relatively elastic. Exhibit 5 shows the demand for natural gas, indicated by marketed production in the period from 1972-1987 and clearly shows that the higher prices for natural gas resulting from the NGPA, perhaps strongly aided and abetted by a national policy of conservation, caused a marked shrinkage of demand for gas. Indeed, the annual demand shrank from about 23 trillion cubic feet in 1972 and 1973 to only about 16 trillion cubic feet in 1986 and 1987. This is what brought about a condition of supply adequacy, a condition which has been known as the "gas bubble.". That condition and that bubble are about to end.

Thus, it is my conclusion that further deregulation will not produce substantial increases in supply. I think there is ample evidence that demand and supply which are roughly in balance currently will only maintain balance by further demand restraint. The FERC's efforts to restructure the pipeline industry and create an "open access" quasi "common carrier" interstate transportation system will not in my opinion make it easy to accomplish the required balance by demand restraint. In the '70s, industrial customers were curtailed so that residences and commercial enterprises without adequate substitute fuel capability could continue to be served. But this system has been largely dismantled. Industrial customers now have their own supplies, and the "open access" created by FERC Orders 436 and 500 permit those supplies to get to them largely free from curtailment. In a deregulated market, the continued ability of LDCs to serve their captive, largely residential, customers will depend upon their ability to compete with those other classes of users, largely industrial and electric boiler fuel customers who are attempting to tie up their own gas supplies. To the extent they tie up such on a long term basis, the reserves involved will no longer be available to serve the captive customers, thus creating supply stringencies in that market. To the extent these other customer groups purchase gas in the spot market, LDCs will be forced to outbid them to obtain their supplies, thereby increasing prices to the captive customers.

I therefore predict that we will soon have shortages in the U.S. natural gas markets. Exhibit 4 relates natural gas production to reserve additions in the U.S. Because discoveries have lagged production virtually continuously during the last two decades, our ability to produce gas is declining rapidly. In my opinion, we will shortly be unable to supply the current demand, let alone expand such. To further deregulate natural gas prices at a time of shortage will not provide the necessary supplies to keep the market balanced but will only restrain or curtail demand. With the aforementioned changes in the nature of the industry, I further predict rapid price increases impacting the captive, largely residential, market. That market is truly gas dependent and, without regulatory controls on producer prices, will have to pay significantly higher prices to have access to the gas it requires.

To my way of thinking, this is a particularly bad time to embark on a new experiment of decontrol. Despite what the advocates claim, recent history is not reassuring that we can rely on gas to fuel our industrial and electric generation boiler fuel needs and we should view with extreme skepticism any policy that drags us in that direction. As the CEO of an LDC that has a service obligation to a large metropolitan area, I fear that passage of decontrol legislation may create an extremely dangerous situation in terms of our ability to meet that obligation in the not too distant future.

EXHIBIT 1



NEW GAS PRICE & WELLS DRILLED

1952 - 1973 PRICE - AVERAGE WELLHEAD COST
1974 - 1978 PRICE - FPC CEILING
1979 - 1980 PRICE - NGPA SECTION 102 CEILING
1981 - 1988 PRICE - NGPA SECTION 102 MARKET

SOURCE: DOE/EIA, AGA, API, CPA

EXHIBIT 2

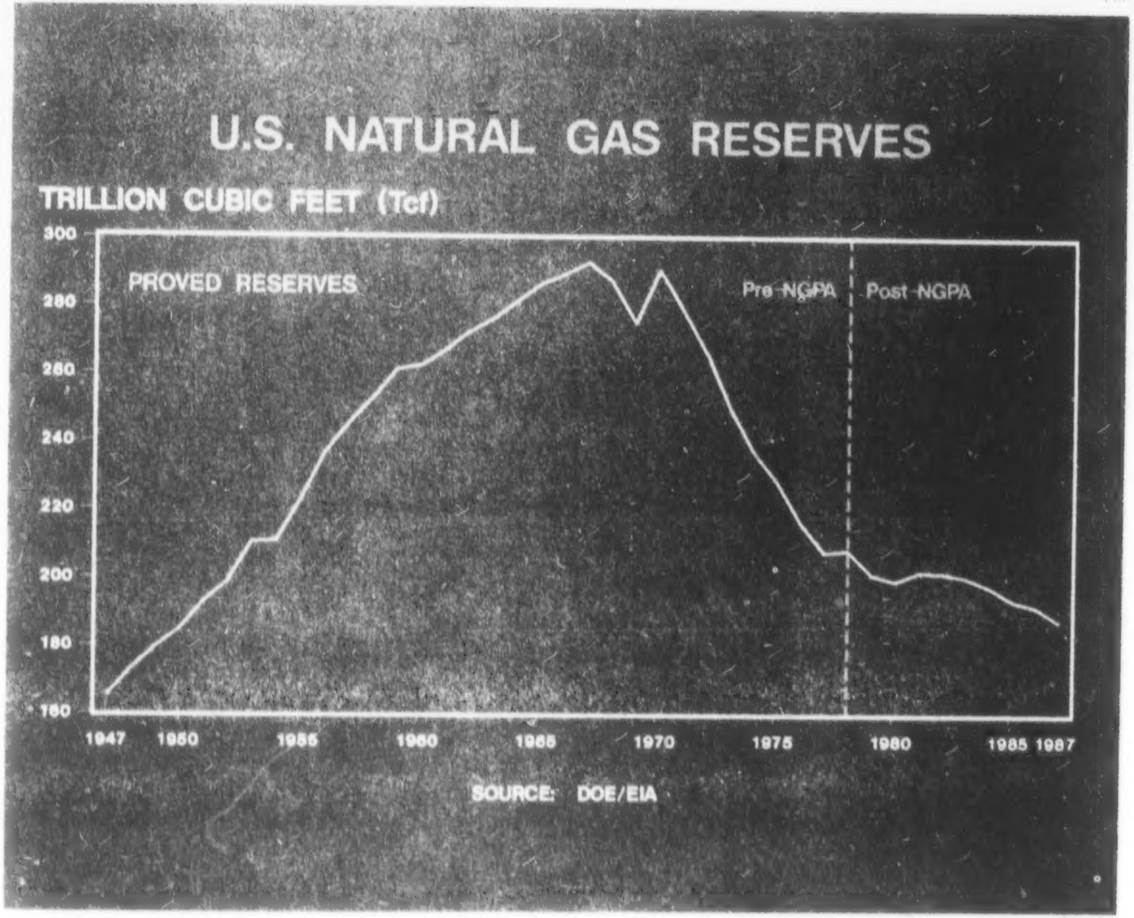
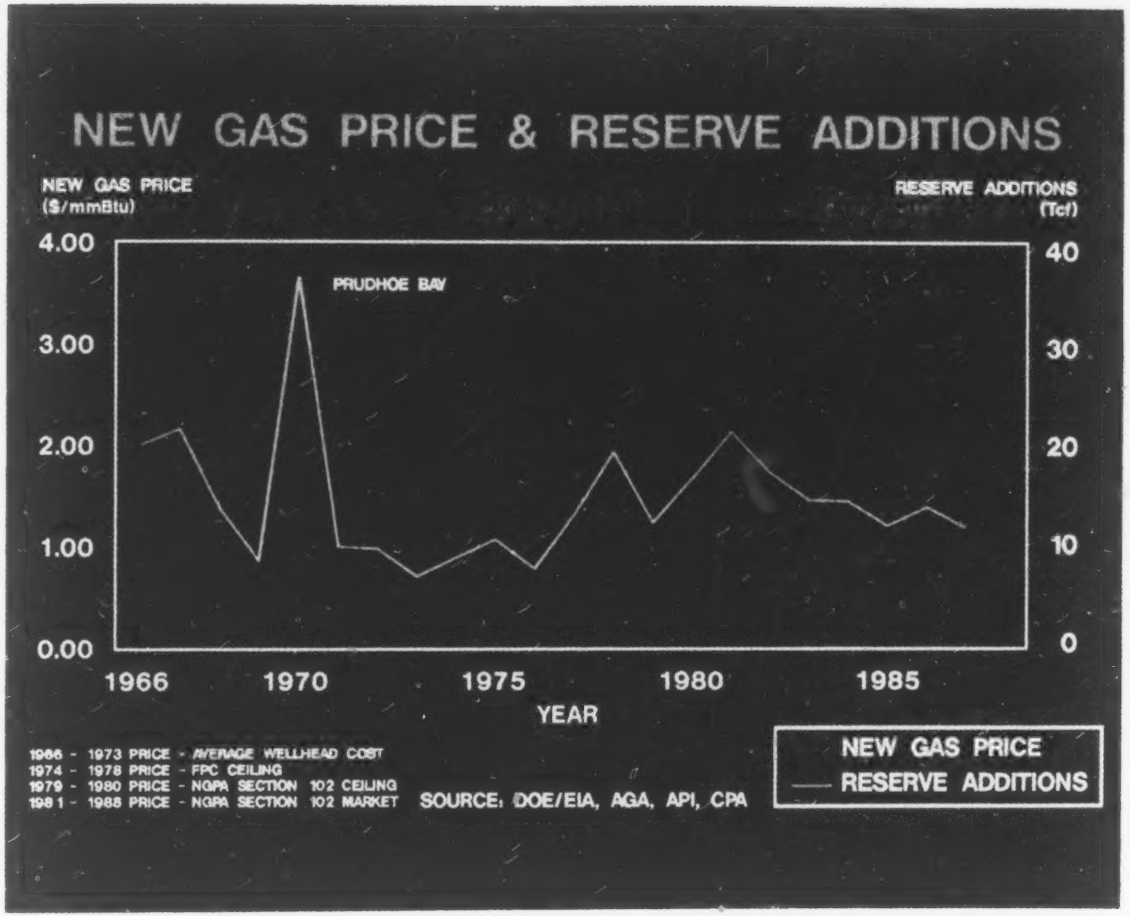

U.S. NATURAL GAS RESERVES
TRILLION CUBIC FEET (Tcf)
300
280
260
240
220
200
180
160
PROVED RESERVES
Pre-NGPA
Post-NGPA
1947
1950
1955
1960
1965
1970
1975
1980
1985
1987
SOURCE: DOE/EIA

EXHIBIT 3



NEW GAS PRICE & RESERVE ADDITIONS

1966 - 1973 PRICE - AVERAGE WELLHEAD COST
1974 - 1978 PRICE - FPC CEILING
1979 - 1980 PRICE - NGPA SECTION 102 CEILING
1981 - 1988 PRICE - NGPA SECTION 102 MARKET

SOURCE: DOE/EIA, AGA, API, CPA

EXHIBIT 4

U.S. NATURAL GAS ADDITIONS AND PRODUCTION

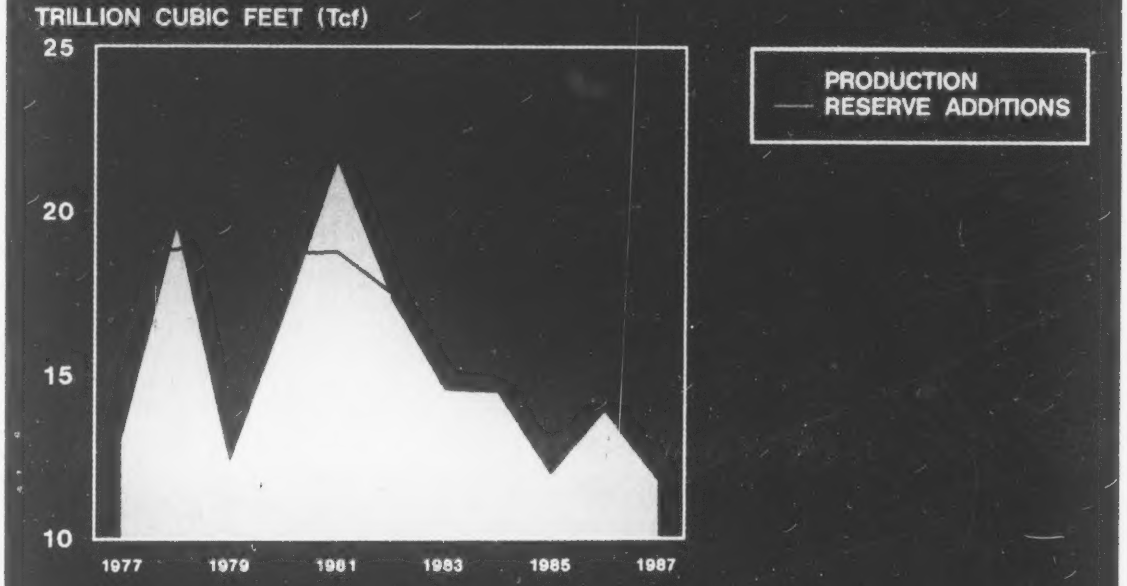
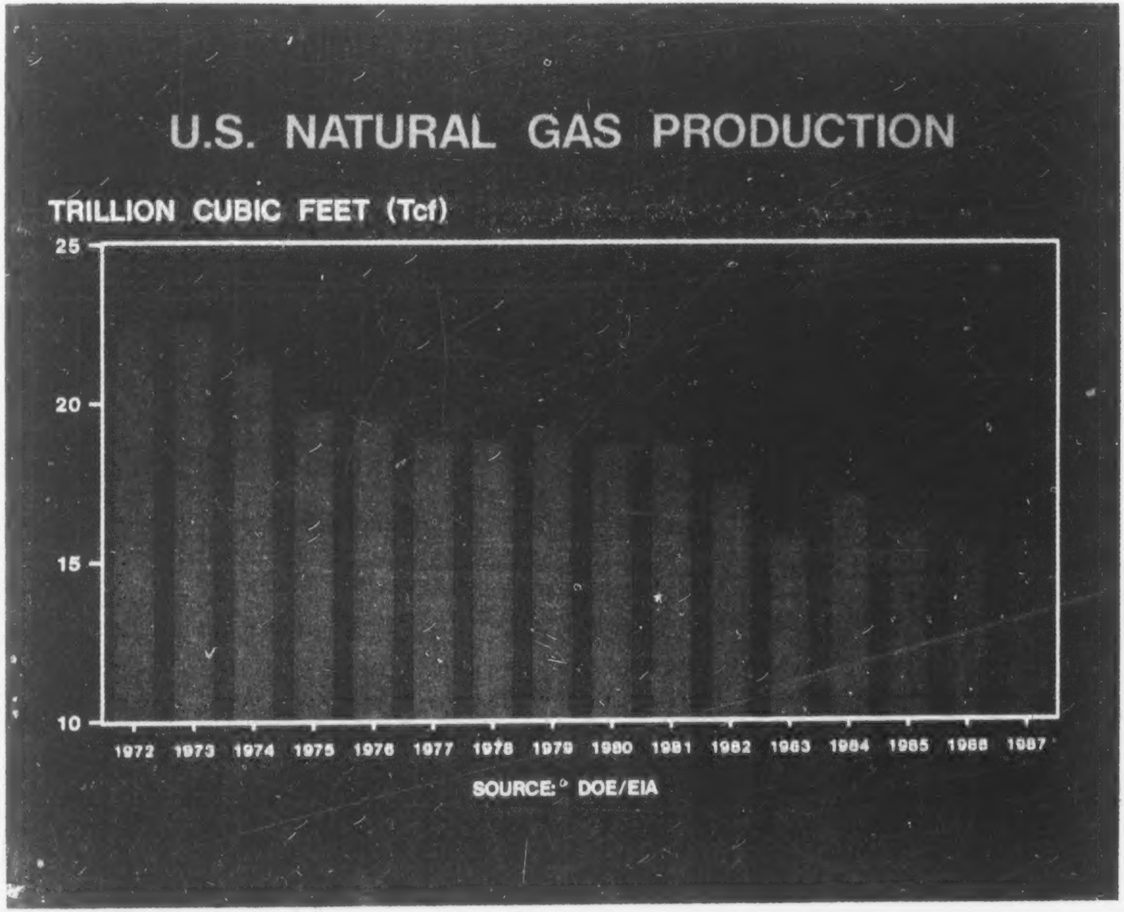


EXHIBIT 5



U.S. NATURAL GAS PRODUCTION

SOURCE: DOE/EIA

Senator **Metzenbaum**. Do I understand that you are opposed to the bill?

Mr. **Liberman**. I am opposed to the bill.

The **Chairman**. Mr. McPhail.

STATEMENT OF ROBERT L. McPHAIL, PRESIDENT AND CHIEF EXECUTIVE OFFICER, DAKOTA GASIFICATION CO.

Mr. **McPhail**. Thank you, Mr. Chairman and members of the Committee.

My name is Robert McPhail. I wish to thank you for providing me this opportunity to appear here today on behalf of the Dakota Gasification Company and the Great Plains synfuels project to discuss the potential effects on Great Plains of wellhead price decontrol and deregulation of the natural gas industry.

I am the President of the Dakota Gasification Company, which owns and operates the Great Plains synfuels project located near Beulah, North Dakota. I am also the General Manager of Basin Electric Power Cooperative. Basin Electric is a taxable consumer-owned regional cooperative responsible for supplying wholesale electric power to 110 rural electric systems serving over one million consumers in eight states: Colorado, Iowa, Minnesota, Montana, Nebraska, North and South Dakota, and Wyoming.

As this Committee is well aware, on October 31st, 1988, the Great Plains coal gasification plant was purchased by Dakota Gasification Company under an asset purchase agreement with the Department of Energy. This agreement assures continued operation of the plant under a revenue-sharing plan which could return to the taxpayers the Federal government's initial investment in the plant.

The sale to Dakota Gasification Company, with its commitment to continue the long-term operation of the plant, gives the Department of Energy the benefit of its original investment and the generation of valuable information concerning synthetic fuels technology. Information gained from the operation of this plant advances the nation's interest in energy security.

The plant also serves as a major source of employment and economic opportunity for the State of North Dakota. The benefits from the gasification project to the Department of Energy, to Basin Electric and its member systems, the taxpayers of the United States, and the people of North Dakota depend upon the continued operation of the Great Plains Dakota Gasification Company.

Dakota's commitment to continued operation of the plant was based upon the continued sale of synthetic gas to the original pipeline buyers under the existing gas purchase agreements. In fact, those contracts were so essential to the transaction that specific representations concerning these contracts were included in the asset purchase agreement transferring the plant from the government to Dakota Gasification Company.

These contracts must remain in effect since they are as vital to the plant today as they were when originally executed. Neither the decontrol of natural gas prices at the wellhead nor the restructuring of either natural gas markets or market participants may excuse the four gas pipeline companies from their obligations to purchase the synthetic gas under our four contracts.

In summary, Dakota Gasification Company has committed to operate the Great Plains plant on a long-term basis so that the plant may continue to contribute to America's energy future both in the production of synthetic gas and in the development of byproducts.

Dakota's commitment depends upon the continued validity of the underlying contracts and the continued purchase of the synthetic gas by the four interstate pipeline buyers in accordance with the terms of the existing contracts.

Finally, we support decontrol of natural gas, Mr. Chairman. But we do not believe that this legislation was drafted to adversely effect the Great Plains gas purchase agreements and their pricing provisions. But because of the importance of these contracts to the success of this project, we believe that the nation will be well served if we could have a clarification to that effect in the legislative history of this bill.

Thank you, Mr. Chairman.

[The prepared statement of Mr. McPhail follows:]

Statement of Robert L. McPhail
President and Chief Executive Officer
Dakota Gasification Company
before the
Committee on Energy and Natural Resources
U.S. Senate
May 8, 1989

Mr. Chairman and members of the Committee. My name is Robert L. McPhail. I wish to thank you for providing me the opportunity to appear today on behalf of Dakota Gasification Company and the Great Plains Synfuels Project and to discuss the potential effects on Great Plains of wellhead price decontrol and the deregulation of the natural gas industry.

I am the President and Chief Executive Officer of Dakota Gasification Company which owns and operates the Great Plains Synfuels Project located near Beulah, North Dakota. I am also the General Manager of Basin Electric Power Cooperative. Basin Electric is a consumer-owned, regional cooperative responsible for supplying wholesale electric power to more than 110 rural electric systems in eight states--Colorado, Iowa, Minnesota, Montana, Nebraska, North and South Dakota and Wyoming.

Great Plains was conceived in the aftermath of the Arab oil embargo of the 1970s amid expectations that energy prices would skyrocket as a result of diminishing supplies. At that time, interstate natural gas pipelines were suffering the consequences of severe natural gas shortages. The developers of Great Plains believed there was great potential for this country to utilize its abundant domestic coal resources by converting coal into synthetic gas which could, in turn, be used to displace foreign petroleum-based energy resources.

The original investors in the Great Plains project were a consortium of affiliates of interstate pipeline companies. Because of the magnitude of the investment, the uncertainty as to the commercial feasibility of the project and because of the vital interest of the United States in the adequacy of domestic energy supplies, these original investors approached the Department of Energy for financial assistance in construction and operation of the plant. In addition to a federal loan guarantee, construction of the plant was further conditioned upon long-term contracts for the sale of the plant's output. This commitment was formalized in the Project's four gas purchase contracts which require the four pipeline company buyers to purchase the full output of the plant at a formula-determined price.

The buyers, the pipeline affiliates of the project sponsors, conditioned their contract commitment to purchase the gas manufactured at the plant on prior Federal Energy Regulatory Commission approval of the contracts to the extent necessary to assure that each buyer could recover the cost of purchasing the synthetic gas on a rolled-in basis under its Purchase Gas Adjustment. These gas purchase contracts were submitted to and approved by the Federal Energy Regulatory Commission pursuant to FERC Opinion 119 which approved such cost recovery on a rolled-in basis.

Subsequently, the Department of Energy, relying upon the gas contracts and FERC Opinion 119, made a $2.02 billion loan guarantee to Great Plains, the facility was constructed under budget and ahead of schedule and production of synthetic gas commenced on July 28, 1984. During that time, Basin Electric and its member systems responded to encouragement from the federal government to join the country's efforts to seek energy independence by substituting electrical energy for foreign oil by maximizing the use of abundant domestic energy resources such as coal and by supporting the development of synthetic and alternate fuels.

The Cooperative, while developing programs to meet the future power supply needs forecast by its member systems, worked closely and entered into binding contracts with the consortium to develop joint facilities between its coal-fired power plant and the gasification plant in a way to realize the most efficient and effective use of resources and material. These joint facilities included fuel supply, water intake facilities, rail facilities and electric transmission facilities.

Unfortunately, the energy price and availability assumptions made by both the private developers and the Department of Energy were incorrect. Great Plains failed to meet its debt service obligations and the original developers abandoned the project on August 1, 1985.

This action placed in jeopardy thousands of jobs and large community investments as well as the substantial investments made by Basin Electric on behalf of its member cooperatives in reliance on a joint project. The Department of Energy, which had assumed ownership of the project, then offered the gasification project for sale on bids. Basin Electric's membership gave its approval for Basin Electric to offer a bid proposal for purchase of the gasification project. When Basin Electric's bid proposal for purchase of the gasification project was selected by the Department of Energy from among a number of competing proposals as the most likely to assure long-term operation of the gasification project, the Basin Electric membership, at a special meeting, approved the establishment of a wholly-owned subsidiary, the Dakota Gasification Company, to own and operate the Great Plains Gasification Project separate from Basin Electric.

On October 31, 1988, the Great Plains plant was purchased by Dakota Gasification Company under an asset purchase agreement with the Department of Energy. This agreement assures continued operation of the plant under a revenue-sharing plan which could return to the taxpayers the federal government's initial investment in the plant. The sale to Dakota Gasification Company, with its commitment to continue the operation of the plant, gives the Department of Energy the benefit of its original investment and the generation of valuable information concerning synthetic fuels technology. Information gained from the operation of this plant advances the nation's interest in energy security. The plant also serves as a major source of employment and economic opportunity for the state of North Dakota.

The benefits of the bargain to the Department of Energy, Basin Electric and its member systems in the region, the taxpayer and the people of North Dakota depend upon the continued operation of Great Plains by Dakota Gasification Company. Dakota's commitment to continue operation of the plant was based upon the continued sale of synthetic gas to the original pipeline buyers under the existing gas purchase agreements. In fact, those contracts were so essential to the transaction that specific representations concerning those contracts were included in the asset purchase agreement transferring the plant to Dakota.

Those contracts must remain in effect since they are as vital to the plant today as they were when originally executed. Neither the decontrol of natural gas prices at the wellhead nor the restructuring of either natural gas markets or market participants may excuse the four pipelines from their obligations to purchase synthetic gas under our four contracts.

In recent years, the natural gas industry has experienced rather dramatic changes. Partial wellhead decontrol under the Natural Gas Policy Act has allowed for wellhead competition. As a result, the pipeline company is no longer the sole gas merchant in its traditional sales market. Today, producers and marketers as well as pipelines sell gas into the pipeline's traditional markets. FERC Orders Nos. 436 and 500 have facilitated pipeline transportation of the natural gas sold by competitors.

Recently, many pipeline companies have restructured their corporate functions reportedly to reflect more closely the changes in the natural gas markets and to compete more effectively for sales in competition with marketers and producers. Most of these pipelines have created marketing affiliates which engage in the nonjurisdictional marketing of natural gas. As a general matter, these changes in corporate structure may be an efficient realignment of the corporate resources. However, corporate reorganization, no matter how compelling the reasons or efficient the result, does not provide a basis for contract abrogation.

Our gas purchase agreements must be maintained regardless of changes in the natural gas industry and regardless of changes in the corporate structure of the pipelines. Indeed, the contracts are vital to the successful operation of the plant and the government's recovery of its investment in the Great Plains project. Therefore, Dakota Gasification Company must oppose any action which might jeopardize the gas purchases under those contracts. For this reason, Dakota Gasification Company has just recently sought to intervene in a Federal Energy Regulatory Commission proceeding where Transcontinental Gas Pipe Line Company, one of the four pipeline purchasers under the gas purchase contracts, has requested interim authority to transfer its jurisdictional sales service obligation to its nonjurisdictional marketing affiliate, TEMCO. Presumably, if Transcontinental is successful, it will no longer make sales of natural gas to its jurisdictional customers and will no longer have a Purchased Gas Adjustment. Dakota Gasification Company opposes this corporate reorganization because if Transcontinental divests its jurisdictional sales market to its nonjurisdictional marketing affiliate, Transcontinental's ability to perform under the contract with Dakota Gasification Company may be jeopardized.

In summary, Dakota Gasification Company has committed to operate the Great Plains plant on a long-term basis so that the plant may continue to contribute to America's energy future both in the production of synthetic gas and in the development of by-products. Dakota's commitment depends upon the continued validity of the underlying contracts and the continued purchases of the synthetic gas by the four interstate pipeline buyers in accordance with the terms of the existing contracts.

We believe that Great Plains continues to contribute to America's energy future both in the production of synthetic gas and in the development of by-products. Given this country's growing dependence on foreign petroleum resources and the growing consensus of the need for a new national energy policy, we believe the day is soon approaching when we will again look, if only for security purposes, to clean coal and the technologies being pioneered by Great Plains to play a vital role in providing for our country's energy requirements.

Finally, we do not believe this legislation was drafted to affect the Great Plains gas purchase agreements and their pricing provisions, but because of the importance of these contracts to the success of the Great Plains project and the nation as well, we seek a clarification to that effect in the legislative history of this bill.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. McPhail.

Mr. Rothschild, prior to partial wellhead decontrol on January the 1st, 1985, the Citizen-Labor Coalition predicted that wellhead prices would fly up by 20 percent and that residential natural gas prices would increase by 14 percent, and of course these predictions did not come true. Does that indicate any flaw in your method of estimation?

Mr. ROTHSCHILD. Well, if it indicates a flaw in my method, it also indicates a flaw in the method AGA uses and INGAA uses and Exxon uses, because we based a lot of our estimates on the fact that Exxon said in 1985 prices for oil would be $50 a barrel. Clearly they were wrong as well.

I am glad you raised 1985, because really what happened that shook everybody up had nothing to do with decontrol. It had to do with the fact that oil was flooded into the world market and brought oil prices down from $29 a barrel, which they were in December of 1985, to about $10 a barrel in the summer of 1986.

So I think no one could predict that, and everyone who made predictions about the impacts of decontrol turned out to be wrong. We were wrong. We admit it. But obviously, you make the best guess you can.

The CHAIRMAN. Well, everybody was wrong on the price of oil, no doubt about that. But it does suggest that the price of oil tends to control the price of natural gas, rather than deregulation.

Mr. ROTHSCHILD. I agree, I think the price of oil does tend to control the price of natural gas. There is no question about it.

The CHAIRMAN. And that the effect of the deregulation itself did not cause any fly-up. I mean, there was not—as you look at the period right around January the 1st, 1985, there was no huge drop right at that point in the price of oil, nor was there a—or increase in the price of oil, nor was there a fly-up in the price of natural gas.

Mr. ROTHSCHILD. What you had was another set of changing circumstances. That is, what FERC started to do with changing the market, setting up special marketing programs to allow producers to sell directly to industrial users. And oil prices had come down from 1981 to 1985.

Of course, that program was found to have been illegal because it did not open up the market to everyone. So there were other changing circumstances. It was not deregulation per se that affected the price of oil. It was the fact that oil prices came down and gas prices followed.

The CHAIRMAN. You have heard Mr. Lawrence testify that some prices of natural gas are held up actually by regulation, others are depressed, and that the two would pretty well offset one another. Do you think that is true or not true on the short term?

Mr. ROTHSCHILD. I do not think that is true, for a variety of reasons, the first of which is the contract provisions. There are some producers in offshore Louisiana, large producers, that have 102(d) gas that have provisions called fail-safe provisions, that say that the price on the day before deregulation shall exist if the deregulated price is lower. So that will keep their prices higher.

I think a better approach, if you are going to deregulate, is simply deregulate everything on one day, with mandatory renegotiation for six months, and you clear everything out, both high gas, high-cost gas that is regulated above the market, and low-cost gas. That would be a more honest and direct approach, as opposed to trying to fiddle with each side of it in some way.

The CHAIRMAN. Well, we have had testimony here that you need that period of time to renegotiate these contracts, particularly those that adopt the highest price in the area, and if you deregulated immediately they would be entitled to a big price, but they need that period of time both for contracts to expire and, in the case of those that do not expire, then to renegotiate.

Mr. ROTHSCHILD. That is why we put in a mandatory renegotiation clause, which would maybe last six months and force everybody to the bargaining table to renegotiate every provision of their contract. So that after six months if they have not done anything, the producer will go out and have to sell his gas in the market.

And if he has gas that is selling for three dollars now and the market is $1.50, he would be forced to sell at the $1.50. If someone has 80 cent gas and it is selling for $1.50 and he could not get a higher price from his pipeline, he could sell it for $1.50.

It would be fair on both sides, is what I am saying. Under the current construction, basically the old gas prices can come up, but not all high-cost prices will come down. And I think the fact that you have a company like Ashland coming in here and talking about the problems with the date of enactment causing them some serious difficulty with some of their gas and getting rid of it will help them keep their prices higher is an indication.

The IPAA did the same thing when the bill was constructed in the House. They were worried about immediate deregulation for fear that some of the stripper well gas that is selling for above three dollars would come down in price.

So I think consumers have a legitimate concern that some producers are going to get windfalls as the price goes up and some producers are going to be protected from lower prices because their price will stay up.

The CHAIRMAN. Your response, Mr. Gooch?

Mr. GOOCH. Well, I truly hope that you do not wipe out every producer, pipeline, distributor, end user contract in western civilization and cause renegotiation in a short period of time.

We need a long-term gas supply. We count on it. We count on our contracts. We are willing to live under our contracts. And when we have a contract with a pipeline, we want the pipeline to be able to live under their contracts. We do not ask you to abrogate any of the contracts. We think it would be total chaos, total chaos, if you simply wiped out every contract and gave everybody a short period of time to renegotiate.

The CHAIRMAN. Well, you heard Mr. Rothschild speak that prices would rise under this legislation.

Mr. GOOCH. Well, let me speak to that. First, let me say that we do not know whether prices will go up or go down or stay the same. Evidence indicates that, according to the EIA data, they would be lower today if there were not price controls than if there were, another several hundred million dollars lower today if there were not price controls. I am prepared to accept that.

Now, what will happen in the future I do not know. It may go up, may go down, may stay the same. But it is going to have the opportunity for the bringing forth, the opportunity to bring forth new supplies, rather than have a Federal agency guess at what price will or will not bring forth new supplies.

They have to make two guesses, and they have been wrong. The administered prices did not keep us out of curtailments in the seventies. And the industrials, if you will forgive me, the industrials paid the price in the seventies.

If there is curtailments again, you still leave intact in the Natural Gas Policy Act the emergency allocation and priority controls, intact to be re-imposed should they become necessary.

The CHAIRMAN. Mr. Lawrence, would you tell me how this Act would elicit new supplies, or this bill?

Mr. LAWRENCE. Yes. I think one of the principal contributors to the Department of Energy study, Dr. William Fisher at the University of Texas, is a great proponent of the tremendous volume of natural gas, some 180 trillion cubic feet out there.

That is in gas-cap gas and old depleted oil reservoirs, behind the pipe, some of the small reservoirs that have been referred to here earlier today, or even bypass gas by water drive by the reservoir mechanism. A lot of those are tied into old fields that have old gas contracts that might still be applicable.

I think when you clear away the underbrush you really permit the market forces to completely work, and I think it is a tremendous potential there of new supplies, getting rid of this underbrush, and that is what it is.

We made a study——

The CHAIRMAN. You are talking about in-field drilling?

Mr. LAWRENCE. Pardon me?

The CHAIRMAN. You are talking about in-field drilling on regulated gas?

Mr. LAWRENCE. Well, we do not want to get into the spudded well provision on that. We have got people on all sides of that one. But I am talking about just getting rid of the remaining NGPA fuel price controls.

We reviewed all of our members and the result was there would be no consumer impact if you did decontrol tomorrow, as was initially proposed on the House side. But we had individual people that wanted the time to phase out and renegotiate some of their contract obligations and maybe mitigate some take-or-pay obligations.

I think this was just about offset by some of the things that the smaller producers had on stripper prices and maybe some of the issues in the spudded well provision. So we are very supportive of the 1/1/93 drop the curtain date, and we think the impact there will be just about offset, those that will come down compared with those that will come up.

But the ultimate benefit to the consumer is going to be to have an unabashed development of this huge natural gas resource base. It is becoming a gas-prone world out there, and this is major oil companies, it is independent producers, it is think tanks.

We need to get at that exploration and development if we are going to get at the efficient generation of electricity that I think is going to benefit electric consumers as well as natural gas consumers.

The CHAIRMAN. Gentlemen, thank you very much.

I am going to ask Senator Metzenbaum to preside at this time. I have got to go preside over a Chamber of Commerce luncheon. You understand that, Mr. Gooch?

Mr. GOOCH. Yes, sir. Thank you very much.

The CHAIRMAN. And so thank you very much. You have been an excellent panel.

Senator METZENBAUM [presiding]. I would hope that when the bill is on the floor that each of the proponents would also see fit to abandon the floor and just leave me alone. [Laughter.]

I doubt that will happen.

Mr. Rothschild, what in your opinion is the motivation for each of these constituent groups that have signed onto this bill?

Mr. ROTHSCHILD. Well, I think you have to examine their relative economic position and what they are after

Senator METZENBAUM. That is what I am asking you to do.

Mr. ROTHSCHILD. The major oil companies—that was my introductory statement.

The major oil companies have a lot of old gas that they have been trying, as people have explained, for 35 years to remove price controls from. They want to have the flexibility.

The major oil companies, as you pointed out, are becoming much bigger in the natural gas business. They are going to become dominant in the natural gas business. I do not think the percentages that one Senator mentioned about Texaco's national numbers mean anything.

Their ability to reduce production, that is hold back supply, is setting a floor under natural gas prices at about $1.50 in the Gulf Coast. That ability has sometimes been pointed to as, look at OPEC, OPEC cannot even do that. The major oil companies are able to set a floor on their prices today.

I think it will get worse in the future.

Senator METZENBAUM. Next group.

Mr. ROTHSCHILD. Next group, the pipeline companies. The pipeline companies have nothing to lose by what happens because they just pass through all of these costs. They are on board because some of them are gas producers and they probably get some kind of benefit.

The independent producers originally did not like total decontrol because it affected some of their high-cost contracts. But the provisions which were included in what is now H.R. 1722 provide them with a way out. It protects their interests for a period of years on the high-cost side.

So I think that—and the industrial users, they have access to the competitive market. Unlike residential and small commercial users, they can buy oil, they can buy gas. They can buy gas from any number of sellers. So they do not care, either. They are indifferent to it and they think it is going to be to their benefit because it will give them more options.

Senator METZENBAUM. Everybody gains except?

Mr. ROTHSCHILD. Residential consumers, and residential consumer are basically, and small commercial and small business consumers, are basically trapped behind local distribution companies who do not have direct access to the market.

Senator **Metzenbaum**. Mr. Lawrence, you do not represent an eleemosynary institution. Neither do you, Mr. Gooch. Why are you here?

Do not tell me because you want to get some more gas. You do not have any—none of you who appear before these committees have any special kind of indicators that they are not here for a selfish purpose. Part and parcel of the American system and I have no quarrel with it.

Why is the American Gas Association for this bill?

Mr. **Lawrence**. Senator, because we serve 170 million consumers of natural gas—residential, commercial, industrial. It is the most substitutable energy for imported oil. It is by far the best environmental compliance energy. It is preferred in 55 percent of the homes, and that gap is widening.

Senator **Metzenbaum**. All this we know. Why are you here?

Mr. **Lawrence**. That is right. We want to be sure that we have a long-term adequate supply to expand that market to residential consumers. We would like to get into natural gas cooling and let us provide a lower cost alternative to electric air conditioning to all these 170 million consumers and shave off those summer peaks of electric use and fill in the summer valleys of natural gas use.

Senator **Metzenbaum**. You are assuming you can get more gas production if prices go up, is that the point?

Mr. **Lawrence**. Well, we do not know that prices are going to go up.

Senator **Metzenbaum**. Then why do you want the bill? Why do you want the bill?

Mr. **Lawrence**. We want to get rid of controls.

Senator **Metzenbaum**. You get all these things, you can get 170 million——

Mr. **Lawrence**. The market works. We had a shortage in the interstate market, an extreme shortage in your state, in the mid-1970's because of interstate price controls. And when the NGPA was passed in 1978, that shortage was eliminated immediately because it got rid of the inter/intrastate disparities. We have had an oversupply ever since.

Senator **Metzenbaum**. You can do all of that without having decontrol. What you are really saying is that, if you get decontrol, we can produce more gas, we will get more production, there will be more incentive to produce it, therefore it is good for the people. Is that essentially the AGA position?

Mr. **Lawrence**. Well, that is not a bad paraphrasing of it. I think if we get rid of this underbrush of control and regulation, as I said in response to Senator Johnston's question, I think there are a lot of very low-cost supplies out there, that there will be unimpaired incentive to really vigorously go after.

But Senator, right now natural gas, because of an oversupply of natural gas and intense gas to gas competition, natural gas is somewhere between half to two-thirds the energy equivalent value of oil. And yet, a lot of people say it is a much preferred fuel, and that is because of that gas to gas competition.

That is why I think with these controls off it is not going to unduly let the price go up.

Senator METZENBAUM. I have trouble understanding that, here it is lower than oil now, much lower according to your presentation on a comparative basis, and much lower according to my own figures, and you are saying if we can increase the price, decontrol it, then there is going to be more of it used. And I have difficulty comprehending that.

Mr. LAWRENCE. I do not know that we are going to increase the price.

Senator METZENBAUM. Well, why take away the controls?

Mr. LAWRENCE. I think competition and more gas to gas competition is probably going to still keep it undervalued with respect to oil. But you are not going to have these regulatory restrictions on development that we now have.

Senator METZENBAUM. Mr. Liberman, would you like to respond to this same line of questioning, as to why, why should we decontrol, what does it do for the American consumer?

Mr. LIBERMAN. I do not think we should. Obviously, you know, I do not think we should decontrol, nor do I think Mr. Lawrence reads history correctly.

In the first place, he never faces the fact that in no year since deregulation or prior thereto, except one and one prior to deregulation, did we replace the reserves we used.

So, if you do not believe that deregulation is going to increase the prices, then it is not going to increase the drilling.

If it does not increase the drilling, it is not going to increase the amount of supply. And I think it will increase the drilling, but I am concerned about the resource base. Now, I do not know whether the gas is actually there or not. Some eminent geologists say it is actually there. But I do not believe it is going to come into production at three dollars a thousand.

We had prices larger than three dollars a thousand in the late seventies and early eighties under the new gas prices, and we got a lot of drilling; we did not get a lot of gas. So I do not think we are going to get the gas.

I do not think decontrol is in the interest of consumers. It is probably color-blind right now as to whether decontrol is going to have any impact, immediate impact on the consumer. But if that is all we are looking at, the immediate impact, we are making a mistake.

It is going to have a long-range impact because gas is going to get short if we do not replace the reserves, and we are not replacing them. Gas is going to get short, there is going to be a scramble to get it, and the prices are going to go up.

Now, maybe industrial customers will pay those prices, maybe somebody else will pay them. But there is one group that is going to have to pay them. That is the residential consumers. They will have to pay them until they get equal to the cost of electricity, and they will have to pay them beyond that because they have got a big sunk investment in their gas-using appliances.

So they are going to get hit hard, and the only thing that is going to keep that hit down somewhat are the controls that are left. Now, I did not think we should have taken off the other controls either, by the way, so I am consistent about that.

Senator METZENBAUM. Mr. Liberman, what kind of a company is Laclede Gas Company?

Mr. LIBERMAN. Laclede Gas Company is a publicly owned—by "publicly owned," I mean privately owned by stockholders. It is a New York Gas Exchange company. It serves 570,000 customers in eastern Missouri. St. Louis, Missouri, is its biggest market.

It serves residential, commercial, and industrial customers, and it does not belong to the American Gas Association, for reasons that are probably pretty clear right now. [Laughter.]

Senator METZENBAUM. Mr. Gooch.

Mr. GOOCH. Yes, sir. I very much appreciate your allowing me to address that.

We want to make things with gas. We have to compete in domestic and world markets to provide not only gas as a fuel, but from gas—80 percent of our petrochemical feedstocks come from it, the ethane, the propane, the butane that ends up in plastics and fibers and medicines and that run the factories.

So it is both a raw material and a fuel. And if we are going to compete in both domestic and world markets, we have got to have the gas.

Senator METZENBAUM. And how do you get the gas? How does this bill get you the gas? By increasing prices, therefore increasing the incentive?

Mr. GOOCH. Sir, it is our hope that that is true. I mean that. I hope that that is true, because the only alternative then is to have the blind hand of choices made in the past, in 1978, as to what the prices should be, or to have the current hand, the current hand of the FERC, decide what the price should be.

And if it is those two choices, it is a clear winner to say, let us have the market. And I believe it is fair to say that we are the ones that are going to hold the prices down.

Senator METZENBAUM. But you assume the passage of this bill will ultimately result in higher prices for natural gas?

Mr. GOOCH. I do not make assumption either way. I think there is a better chance, a much better chance, of having a long-term reliable supply of gas at a reasonable cost through this methodology than either having the Congress mandate a price or have some Federal agency guess it in there.

Senator METZENBAUM. I just want an answer from each of you up or down. In the year following passage of this bill, will the price of natural gas go up or down, your prediction?

Mr. GOOCH. I have none.

Senator METZENBAUM. I cannot believe it. I cannot believe it.

Mr. GOOCH. Well, it is true, sir.

Senator METZENBAUM. I cannot believe it, but I accept it. You have the right to take the Fifth, and to me saying you have none and being in the position that you are in in this industry means that I just cannot believe it. But you have a right to say it.

Mr. GOOCH. Well, sir, you have—may I say something?

Senator METZENBAUM. Sure.

Mr. GOOCH. You have been given other misinformation, such as the fact that the industrials do not make—do not pay any of these take-or-pay payments. That is incorrect. If you look at the facts you will see that the Federal Energy Regulatory Commission does in fact put take-or-pay payments on those portions of the gas paid by the industrial consumers.

So I am sorry, I am sorry that you find my testimony incredible, but it is at least sincere.

Senator METZENBAUM. No, not your testimony, but the answer to my question, which was do you think it will go up or down. For you to say you have no opinion, I find that to be incredible.

Mr. GOOCH. Well, I really do not, though.

Senator METZENBAUM. All right.

Mr. Lawrence, do you have an opinion?

Mr. LAWRENCE. Yes, I will give you our projection for the next two years. We think prices will be up about the rate of inflation, or flat in real economic terms, over the next two years. So that would include the first year that you mention.

This followed kind of a steady decline beginning in 1983, five years of declining gas prices. We think that troughed out in 1988 and that 1989 and 1990 will be about in line with inflation.

Now, could I just make one other point in answer to Mr. Liberman's comment that only in one year have we totally replaced reserves? Absent 1988—we will see how that comes out. But in the eleven years preceding the Natural Gas Policy Act—we go back to 1968 because that was the first year that production exceeded reserve additions. In that eleven year period, reserve additions were 46 percent of production.

Now, in the nine years since the NGPA they have been 90 percent of production. Not 100 percent, but twice as much as in that pre-NGPA period. And this was a time of oversupply and intense gas to gas competition.

So the deregulatory movement of fuel prices has benefited supply.

Senator METZENBAUM. Has been what?

Mr. LAWRENCE. Has benefited the long-term supply of natural gas for all consumers.

Senator METZENBAUM. Mr. Rothschild, in the year after passage, what will happen?

Mr. ROTHSCHILD. In terms of the prediction, I will just quote Chevron's view because I share their view. In their annual report they say:

"The company forecasts an end to the U.S. gas surplus early in the 1990's"—which I take as probably next year—"causing gas prices to rise faster than crude oil prices for the rest of the decade." And I will go with Chevron.

I want to make one other point——

Senator METZENBAUM. On behalf of Chevron, I want to tell you thank you very much. [Laughter.]

Mr. ROTHSCHILD. With regard to this development of reserves from decontrol, the fact is that Congress anticipated this. That is why they put Section 103. 103 is a higher price for gas drilled into old fields. That is number one.

Number two, there is nothing in the current law that prevents producers from lowering their prices. All that Congress did was put a price ceiling on natural gas. They did not put a price floor.

So all those producers who are just worried about the impact of the free market, that the price is going to go down, the question is why are they not lowering their prices today? And the reason is that they prefer the regulatory constraints that allow them to collect higher prices and that is what they want to preserve at least as long as they can, until 1993.

Senator METZENBAUM. Mr. Liberman, do you have a prediction as to what will happen in the year after this bill becomes effective, if it becomes effective?

Mr. LIBERMAN. I do not think much is going to happen in that short a time frame. But you are deregulating gas from here on forward, I guess until we get back here and try to say we made a mistake, and that will be a longer, harder battle than this one.

I think if you look out in the future, it is only going to go one way, up. If it were not going to go up, the Natural Gas Supply Association, IPAA and all those people would not be here testifying for it.

There is only I think two people so far have been against this bill, and that is Mr. Rothschild, whom I find somewhat of a strange bedfellow and myself.

But at any rate, we think in the long run it will go up. And why will it go up? Because supply—right now there is a little excess of supply over demand. There has been for the last three or four years. That is going to be used up. Even the AGA says that. I have got a chart of theirs that shows the bubble comes to an end in 1990, I think. That is next year.

When that happens, if they keep trying to drive up the usage of gas and if they do not keep finding—you cannot get along on finding less than you use. I do not care whether you find more than you used to find or not, you cannot get along finding less than you use.

When that happens, the price is going to go up. That is the simplest law of supply and demand I know. If supply does not go up, the price will go up until the demand will not take it any longer. And that is what happened before; it will happen again.

Senator METZENBAUM. Thank you.

And Mr. McPhail, do you have an opinion as to what will happen the year after decontrol?

Mr. MCPHAIL. In my opinion, the price will go up no matter whether you pass this bill or not. I think the price of gas is going to go up in the future.

Senator METZENBAUM. About how much in the first year, second year?

Mr. MCPHAIL. I have no idea.

Senator METZENBAUM. Thank you.

Senator Conrad, I do not have to speak at the Chamber of Commerce. I am not sure they want to hear my views. [Laughter.]

Senator CONRAD. Gee, I am surprised by that.

Senator METZENBAUM. But I will turn the meeting over to you. If you will adjourn it when you conclude.

Senator CONRAD [presiding]. I would be glad to do that.

I would like to ask, Mr. Liberman, why should we not let the market determine the price of gas? What philosophical or other reason can you give for maintaining regulation?

Mr. **Liberman**. Well, I think that is a very good question. It is one that gives me a great deal of trouble, because I am really a free marketer. But the real reason you cannot do that is that we allowed through regulation and through the policies of the fifties and sixties, we allowed millions and millions of people to use gas, to get on our systems, people that really cannot afford to make a change, they are your constituents and the constituents of the rest of the people here.

Therefore, if the market is deregulated and if the prices go up, these millions of American people are the people that are going to be adversely impacted. These are my customers, these are your constituents.

Now, I do not say it is not right as far as the Nation's total economic activity that we should not have decontrol. But this is a product in which the greater part of this nation has a very great vested interest, and so we have to keep the price as low as we can.

Now, you know, the oil industry was all for deregulation of the oil industry, but now they are a little bit disappointed because what they did is they transferred the oil regulation from this Congress to the OPEC countries. And when the OPEC countries started flooding in the oil, the price went down.

But when that stops, when oil goes up, gas is going to go up with it. And it is only because of a matter of equity to these people that have substantial investments in our systems and who I do not think will be able to easily withstand it.

This Congress today is devoting I think close to $2 billion of the country's resources to try to help pay gas bills of people that cannot afford to pay them at their present level. And that number, that number of people is going to go up and the amounts are going to go up substantially if this bill becomes law, in my opinion.

Senator **Conrad**. All right.

Mr. Lawrence, can you tell me why the Congress, in trying to discharge its public responsibility, should not accept the argument of Mr. Liberman? You have just heard the case that he has made.

I personally believe gas prices are going up. I mean, my friends in the oil industry tell me gas prices are going up, that a lot of factors are out there that are going to lead gas prices to increase.

Do we in your judgment have any responsibility to those people that were brought into gas systems and now are locked in, those residential consumers? Do we have any obligation to protect them or not?

Mr. **Lawrence**. Well, you bet we do. And I think that obligation goes to supply, price, reliability of service, et cetera.

We have seen what price controls can do to reliability of supply and reliability of service. We have also seen what removal of price controls would do as far as prices are concerned. And in both cases it has been beneficial.

You know, economists in our country argue about a lot of things, but they agree on one: how to create a shortage. You put on price controls; it works every time. And you take them off, you begin to get rid of it.

I think one of the things that is being vastly misjudged right now is the nature of the gas-prone resource base and the exploration and drilling that will be gas-prone in the future. And I think you are going to continue not just inter-fuel competition, where gas will be able to compete with oil and coal with scrubbers and electricity and uranium and so forth, but I think you will continue in a period of rather intense gas to gas competition.

I think the market is going to work. We have heard producers in years gone by say, I will get you all the gas you want at five dollars, then four dollars, then three dollars.

We had a prominent independent producer at one of our security analysts meetings recently, and he had just been crying a river about how he had cut his exploration budget. And someone asked him: Well, what would it take to really get you to rehabilitate that exploration budget? He said: Well, $1.85 would look awful good.

I think most producers do not really know. Certainly I do not know what the incentive will be. But giving this market an opportunity to work and I think increased demand is going to stimulate that gas-prone exploration and drilling that is going to develop a lot of gas at very competitive prices.

But I will stand by my prediction early on. I think the price over the next two years, that decline has troughed out and that it will go up about in line with inflation the next couple of years. And projections much beyond that are not too useful.

Senator CONRAD. Mr. Rothschild, I saw you shaking your head.

Mr. ROTHSCHILD. What concerns me, again coming back, is what is not in the bill. I mean, you are concerned about the gas plant. If that had to work in a competitive market, you could not sell any gas from that plant. So you know, you try to arrange things so that that can continue for economic reasons and past practices.

I think residential consumers are getting a bum deal. They are getting a bum deal because of all of the costs that are being loaded onto them by the FERC, particularly take-or-pay.

Now, Mr. Gooch will say, well, industrial customers are getting to pay a lot of it. They are not. They are not paying any near enough of what they ought to pay, because the FERC did not include take-or-pay costs on transported gas.

Mr. GOOCH. That is not true.

Mr. ROTHSCHILD. That is right, it is true. You are not paying your fair share of take-or-pay costs.

Local utilities are not paying anything yet. Any state commission has not put any of those take-or-pay costs on local distribution companies.

The last people that should be paying any take-or-pay costs are residential customers. They were not consulted about these contracts that were signed between producers and pipelines and they were not the cause of the problem creating the take-or-pay liabilities. They should be the last people to pay anything.

The people that caused it were the industrial customers, because they took advantage of the FERC's allowing them to buy gas directly from producers and forcing pipelines into incurring greater and greater take-or-pay costs. That is the problem, and if the Congress does not set that straight you are going to see the future increases on the residential side grow.

Moreover, industrial users——

Senator CONRAD. Let us just stop there, if you do not mind, and we will come back.

I would like to get Mr. Gooch's response to that. I noticed that you had some sharp disagreement with that. Let me deal with those issues and then we will come back to Mr. Rothschild.

Mr. GOOCH. If I may sir, thank you. I would like to address the take-or-pay issue. First of all, Mr. Rothschild I think overlooks the fact that there are substantial quantities of gas being sold by interstate pipelines to local distribution companies, who in turn resell them to the industrial users.

To the extent that the Commission has found that take-or-pay costs were prudently incurred and allowed to be put in rates, those go through to the industrial consumers, just like the residential consumers, as part of their commodity cost of gas. Point one.

Point two, under the Commission's new policy under Order 500 the take-or-pay buy-out and buy-down costs are spread on all throughput, both transportation and sales. And as both the Chairman has said and Commissioner Trabandt has said, you are going to have—well, Commissioner Trabandt said it was something like $27 billion in take-or-pay liability, reduced to $8.7 billion.

Of that, I think Ken Lay said that 40 percent will be eaten by the pipelines' shareholders. Both Chairman Hesse and Commissioner Trabandt say that 40 percent will go direct bill, which also will go to all classes of customers through Mr. Lawrence's constituents. And the remaining $1.7 billion will be spread over all throughput, which means the transportation customers.

Who are the transportation customers? They are also the LDC's. You cannot equate transportation with just industrials. Most of it until recently has only been on behalf of LDC's. And they will either relay it to industrials or keep it for themselves.

So it is a totally baseless charge to say that industrials escape the take-or-pay payments.

Senator CONRAD. Mr. Rothschild?

Mr. ROTHSCHILD. Well, it is not totally baseless. I mean, the fact is that, first off, in terms of the direct bill, the state commissions—the Virginia State Commission has said that, we cannot charge these costs on to industrial customers because they will switch to oil. So in many cases, what may appear from the FERC level, looks like it is going to be paid for by all the customers of an LDC, ends up not being done because the state commission, like the FERC, tries to shift the cost to those who have to pay, namely the residential customers.

So they are getting away with minimal amounts of charges on their costs, on their take-or-pay costs. So I am not saying that all of them are being avoided. I am saying it is being minimized and the maximum is being flowed through to residential or captive consumers who have no choice.

What the industrial customers do at the local levels, they come back and they tell the state commission: Gee, you know, if you add these costs on it is going to make gas more expensive for us and we will have to shift to oil and therefore you will not collect any money from us and that is going to raise all your costs.

So they use a little blackmail so they can get away from paying those charges. That happens in state after state.

Senator CONRAD. Let me go back to you, Mr. Rothschild, with the question that I asked Mr. Liberman. Why should not the market be allowed to work here?

Mr. ROTHSCHILD. Well, if you are going to allow the market to work, Senator, you are going to have to shut down the Great Plains plant, because you could not sell gas from that plant at a competitive price of $1.50 or $1.60.

If you want the market to work, you should deregulate everything immediately, with mandatory renegotiation, because then you will admit that you are abrogating old gas contracts and all contracts subject to the NGPA, rather than allowing some people to protect themselves through various changes in the proposed legislation.

I have no problem with that as long as you recognize what you are doing is going to make everyone work on an equal or level playing field, as people in the gas industry like to say.

But that is not what is happening. That is not the bill before this Committee. No one wants to have immediate deregulation and mandatory renegotiation. The only people who wanted to go one step is the Natural Gas Supply Association, who says we favor immediate decontrol. But they are the only ones.

Independent producers do not want the free market to work. They certainly do not applaud that. Bud Lawrence does not want the free market to work. He does not applaud immediate decontrol, because some of his pipeline members have some problems with immediate decontrol.

So when you talk about the free market, look at who is wanting what from it and you will see that they do not really want the free market immediately. It depends on how their immediate economic position is being affected by that.

So we would say, go ahead, deregulate immediately with mandatory renegotiation, but also take care of other things that would have been taken care of in the free market. There would not have been any take-or-pay costs in the free market.

If you tried to have oil producers collect some bills, they did not. They lowered their oil prices. But on the gas side what you had is, they did not lower their prices. They were allowed to. They only had gas ceilings. But they did not.

All these incursions of take-or-pay costs, that also concerns us because that is not being eliminated through the free market either.

Senator CONRAD. Mr. Gooch?

Mr. GOOCH. I just want to say first, that I guess he cut it short, his colleague here also representing the largest consumer group, or attempting to, the industrial consumer. But we would vastly prefer, we are on record as preferring, immediate decontrol. So that is not an issue.

But we do not raise that because we will take any of those three bills to get to that ultimate goal. And so I just wanted to be included among those who would support immediate decontrol.

With respect to Great Plains, I think it is very fair to say that it was extremely important to this country at the time to examine the technology, because who knows when and whether we will need that technology desperately? And so I for one would make no apologies for the Great Plains project.

Senator **Conrad**. Let me indicate, I make absolutely no apology for it. I think it made substantial sense at the time it was done; it continues to make sense given the volatility of world energy markets. And the fact is this was an attempt for us to learn something, and we are learning.

So we entered into an agreement which in hindsight does not make as much economic sense as it was anticipated to make. But there is no question that we have learned substantially from that and continue to learn. So I make no apology.

I understand the reference that Mr. Rothschild was making. It is certainly not a free market enterprise. It is an enterprise that we isolated from the free market for a specific purpose. That purpose was to enhance the energy independence of the country, and I know Mr. Rothschild understands that. He was really, I think, making a point.

Mr. Lawrence?

Mr. **Lawrence**. The Great Plains project was the only, to my knowledge, major energy project completed on time, under budget, and which technologically and operationally works at least as well or better than anticipated. It is as you said: Economics in many ways passed it by, but it serves, it does serve a purpose.

As to the decontrol now bit, our position on this is to obtain a consensus, just as I think Mr. Bush was saying, Mr. Gooch and Mr. Bush earlier were saying. The impact of decontrol now on the consumer is about the same as in 1983, but there are individual winners and losers on both sides of our Association.

But it is very important that we get this consensus of support so that we can get to this decontrol. And it is happening immediately and will continue to happen right up until 1993.

Senator **Conrad**. Let me ask Mr. McPhail, if I might, and then I am going to give everybody a last shot, because I know sometimes you are in a hearing like this and you have a last thought you want to share. So we will give everybody that last opportunity.

But Mr. McPhail, if I might, what is necessary in your judgment in this legislation or in the legislative history to assure that we do not have the unintended consequence of the Great Plains synthetic fuels project being jeopardized by what we do here?

Mr. **McPhail**. Well, it would be nice to have it clearly stated in the legislation that this was not intended to abrogate or change or modify those contracts, because the contracts are the basis which make that project economically viable to continue to operate.

Senator **Conrad**. So what you are saying is we ought to seek specific language that makes clear that it was not an intent of Congress to in any way affect those contracts? That is what we ought to be shooting for?

Mr. **McPhail**. Yes, sir.

Senator **Conrad**. Well, that is what we will try to do then.

Let me now go back and, starting with Mr. Gooch, go through the panel, if you have any last observation before we complete this hearing?

Mr. **Gooch**. Thank you very much. I appreciate that.

Price controls did not keep us out of curtailments and price controls are not going to keep us out of curtailments in the future; and price controls, as we saw in the early eighties, did not shield any class of consumer from higher gas prices.

There is no basis for any faith or hope that the maintenance of the status quo or even the re-imposition of price controls would be beneficial. The market is the only thing that we have to hope for for a long-term supply of gas at a reasonable cost.

Senator CONRAD. Mr. Lawrence?

Mr. LAWRENCE. I think every 50 years or so we go through different energy eras. We had an era of firewood, coal, oil. And I think now we are entering the worldwide energy era of natural gas.

We hosted a World Gas Conference here in June of last year. President Reagan spoke at it, several prominent Members of Congress. We had over 4,000 people from 55 nations from all over the world. We had the top spokesmen of all the major countries.

And to a person, they all said that natural gas was going to be an increasing portion of their nation's energy mix. Now, very few of those nations, very few, have our indigenous resource base, and none of them have our delivery and storage system. Now, those are national assets and a natural asset. And I think S. 783, getting rid of the final remnants of Federal fuel price controls, is going to help natural gas make that contribution in this country.

Senator CONRAD. Thank you.

Mr. Rothschild.

Mr. ROTHSCHILD. I would just like to take the opportunity to clear up a couple of distortions, one being that regulations created the curtailments and shortages. That is hogwash. The fact is that there were two different markets, a regulated interstate market and a deregulated intrastate market.

If both were regulated, you would never have had the problems, because producers would not be able to sell gas and starve one market, sell gas into the unregulated market and starve the interstate market.

I also would like to clear up the fact that the curtailments in Ohio in 1977 had something to do with price controls. It had absolutely nothing to do with price controls.

What it was, it was one of the coldest winters in 100 years. Capacity was filled. The fact is that Columbia of Ohio made some contracts that it should not have for some of its industrial gas. And that is what caused the problems and factories and schools to shut down in Ohio. It had nothing to do with price controls, and that is on the record because the Senate and the House looked into that.

Finally, I think what you have to consider in this legislation is what you are also going to do is not simply eliminating price controls, you are also making it—you are just simply providing for abandonment, immediate abandonment of service.

One of the things that was preserved is that producers had to go to the FERC to get abandonment authority, to sell gas elsewhere. Now, instead of having gas for the interstate market, as was anticipated, this legislation wipes that slate clean.

It is not just the price control elimination; it is also eliminating the service requirement that producers have to serve particular pipelines in the marketplace. And I think that ought to be looked at closely before the Committee goes any further in the legislation.

Senator CONRAD. All right.

Mr. Liberman?

Mr. **Liberman**. Yes, I would not agree. I think regulation did cause the shortages up to a point. I think up until through the mid-fifties into the sixties prices were far too low.

I think the shortages were wiped out by the fact that the prices for gas got too high, and unfortunately it did not elicit the supply. It depressed the demand, so we had a surplus.

That happened—we were cured of that before deregulation occurred in 1985. We were cured of that by 1980. We did have much higher prices by 1980.

And I am concerned, the shortages are going to recur. I would agree with the gentleman on the end, Mr. Gooch, we are going to have curtailments again. So the real question is how do you handle curtailments?

Well, I think when you have curtailments they have to be handled by law in some way. There has to be some kind of administrative rules as to who gets curtailed and who does not, and there has to be some way of allocating prices so that great economic rent is not captured.

Now, my business, the distributor business, is regulated. The pipeline business is regulated. And the producer business, if it is deregulated, will capture those rents if there is a shortage, and that is all.

If I believed there was going to be plenty of natural gas and if we could keep finding plenty of gas, I would be on the other side of this argument.

Finally, I just want to make one word about take-or-pay, et cetera. I think this Congress ought to look at the take-or-pay issue. The Commission has been abjured to look at it by the courts.

You set a price, a ceiling price for gas, and then producers and pipelines entered into contracts to buy gas at or equal to those ceiling prices, and they also entered into a contract to take or pay for gas they could not buy. Now, if that is not finding a way to pay more than the actual price of the gas allowed by Congress, I do not know what it is.

We, Laclede Gas, and one other customer that I know of—I think maybe the AGA is even on that issue—are asking Congress to take a look at why, looking at asking the courts to take a look at why did the FERC not invoke their powers under Section 5. That is the last thing they have done. But I would think the Congress would have some control of this.

One other thing I think the Congress ought to be looking at. The FERC issued Order 451 and they said all old gas prices would go up to the post-1975, to the '75-'76 price. That is an authority that lies in this Congress. It does not lie in the FERC. But oversight has not done much about that.

But I am concerned about the natural gas industry. I am a part of it, I have been a part of it for 43 years. I think we have an obligation to our customers and that obligation is to keep that price down when market forces cannot do it any longer, distasteful as that is to me.

Thank you.

Senator **Conrad**. Mr. McPhail, the last word.

Mr. **McPhail**. I have no further comment, Senator. [Laughter.]

Senator CONRAD. You will find that that is a very popular position with the committees of Congress.

Let me first thank all of you. I think you have been absolutely excellent witnesses and this has been a useful debate, certainly for this member and I think for the record as well.

I want to indicate that the record will remain open for one week for the purpose of submitting additional questions.

With that, we will end this hearing.

[Whereupon, at 1:24 p.m., the hearing was adjourned.]

APPENDIXES

APPENDIX I

Responses to Additional Questions

J. BENNETT JOHNSTON, LOUISIANA, CHAIRMAN

DALE BUMPERS, ARKANSAS
WENDELL H. FORD, KENTUCKY
HOWARD M. METZENBAUM, OHIO
BILL BRADLEY, NEW JERSEY
JEFF BINGAMAN, NEW MEXICO
TIMOTHY E. WIRTH, COLORADO
KENT CONRAD, NORTH DAKOTA
HOWELL T. HEFLIN, ALABAMA
JOHN D. ROCKEFELLER IV, WEST VIRGINIA

JAMES A. McCLURE, IDAHO
MARK O. HATFIELD, OREGON
PETE V. DOMENICI, NEW MEXICO
MALCOLM WALLOP, WYOMING
FRANK H. MURKOWSKI, ALASKA
DON NICKLES, OKLAHOMA
CONRAD BURNS, MONTANA
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FRANK M. CUSHING, STAFF DIRECTOR FOR THE MINORITY
GARY G. ELLSWORTH, CHIEF COUNSEL FOR THE MINORITY

United States Senate
COMMITTEE ON
ENERGY AND NATURAL RESOURCES
WASHINGTON, DC 20510-6150

May 10, 1989

The Honorable J. Allen Wampler
Assistant Secretary for Fossil Fuels
U.S. Department of Energy
1000 Independence Avenue, S.W.
Washington, D.C. 20585

Dear Secretary Wampler:

Thank you for appearing before the Committee on Energy and Natural Resources on Monday, May 8, 1989, to offer testimony on S. 783, S. 625 and H.R. 1722.

Enclosed are additional questions relating to the May 8th hearing. I would appreciate receiving your answers to these questions by Monday, May 15, 1989, so that we are able to continue our review of this legislation.

Thank you for your assistance.

Sincerely,

J. Bennett Johnston

J. Bennett Johnston
Chairman

JBJ/dfs

Enclosure

QUESTIONS FOR ASSISTANT SECRETARY WAMPLER
FROM SENATOR JOHNSTON

PRICE IMPACT OF DECONTROL

1. Compared to the situation that would transpire absent the enactment of natural gas wellhead decontrol legislation, what will be the likely impact of wellhead decontrol legislation upon the price and supply of natural gas?

   - o Please direct your answer to the price and supply situation in the year immediately following decontrol and in the year five years after decontrol.

   - o Please explain your answer and any assumptions upon which your answer is premised.

2. What factors other than wellhead controls (or the repeal of such controls) are likely to affect natural gas prices and supplies in the next decade?

QUESTIONS FOR ASSISTANT SECETRARY WAMPLER

FROM SENATOR JOHNSTON

PRICE FLY UP

What forces will operate to prevent a price "fly up" upon decontrol in January 1993?

QUESTIONS FROM SENATOR METZENBAUM FOR ASSISTANT SECRETARY WAMPLER

YOU SAY IN YOUR OPENING STATEMENT THAT DEREGULATION WILL SEND PRICE SIGNALS THAT WILL ENCOURAGE INCREASED EXPLORATION AND DEVELOPMENT. DOESN'T THAT MEAN THAT DRAMATICALLY HIGHER PRICES WILL BE THE TRIGGER FOR INCREASED EXPLORATION?

DO CAPTIVE GAS CUSTOMERS HAVE TO PAY A PREMIUM OVER THOSE PRICES TO GET SECURE, LONG-TERM SUPPLIES TO BE SURE THAT THEY CAN HEAT THEIR HOMES AND BUSINESSES?

WHAT IN YOUR OPINION ARE THE FOUR MOST IMPORTANT STEPS D.O.E. SHOULD TAKE TO PROMOTE THE EFFICIENT USE AND COST-EFFECTIVE CONSERVATION OF NATURAL GAS? SINCE NATURAL GAS IS SUCH A PREMIUM FUEL, SHOULDN'T ITS EFFICIENT USE BE ONE OF THE DEPARTMENT'S HIGHEST GOALS?

AS OF 1989 WHAT PERCENTAGE OF SALES GAS IN THIS COUNTRY IS PRODUCED BY EACH OF THE TOP TEN OIL COMPANIES? ARE THESE FIGURES INCREASING OR DECREASING OVER TIME?

AS OF 1989 WHAT PERCENTAGE OF NATURAL GAS RESERVES IN THIS COUNTRY IS PRODUCED BY EACH OF THE TOP TEN OIL COMPANIES? ARE THESE FIGURES INCREASING OR DECREASING OVER TIME?

QUESTION FROM SENATORS CONRAD AND McCLURE
APRIL 8, 1989

NATURAL GAS POLICY ACT AMENDMENTS

QUESTIONS FROM DEPARTMENT OF ENERGY.

1. If an action were proposed which could modify the Great Plains synthetic fuels production contracts so as to potentially adversely effect the projects economic viability, would the Department oppose such action?

2. If and action were proposed which could modify the four agreements pursuant to such contracts to which synthetic natural gas produced by the Great Plains Synthetic Fuels Project is sold to the four major natural gas pipelines companies, would the Department oppose such action?

3. In the judgement of the Department, could the natural gas legislation (S. 625, S. 783 or H.R. 1722) currently pending before the Committee either directly, or indirectly, effect the Great Plains synthetic fuels production contracts or the four agreements pursuant to which synthetic natural gas produced by Great Plains Synthetic Fuels Project is sold to the four major natural gas pipeline companies? If so, what could be the potential adverse effect?

4. Currently pending before the Federal Energy Regulatory Commission is an April 3, 1989 proposed settlement agreement filed by the Transcontinental Gas Pipeline Company.

   a. If the Transcontinental Gas Pipeline Company is successful in transferring its jurisdictional sales service obligation to its non-jurisdiction marketing affiliate, TEMCO, could this action directly or indirectly effect the Great Plains contract or its agreement with Great Plains?

   b. Similarly, could this action directly or indirectly effect the revenue stream from the Great Plains synthetic fuels project?

   b. What action does the Department intend to take with regard to the pending FERC proceeding to both indicate its concerns regarding any direct or indirect effects of its action on the Great Plains Synthetic Fuels Project?

POST-HEARING QUESTIONS AND ANSWERS

RELATING TO THE

MAY 8, 1989

HEARING BEFORE THE

COMMITTEE ON ENERGY AND NATURAL RESOURCES

U.S. SENATE

J. ALLEN WAMPLER

ASSISTANT SECRETARY FOR FOSSIL ENERGY

QUESTIONS FROM SENATOR JOHNSTON

Question 1: Compared to the situation that would transpire absent the enactment of natural gas wellhead decontrol legislation, what will be the likely impact of wellhead decontrol legislation upon the price and supply of natural gas?

- Please direct your answer to the price and supply situation in the year immediately following decontrol and in the year five years after decontrol.
- Please explain your answer and any assumptions upon which your answer is premised.

Answer: Currently the gas market is made up of a patchwork quilt of contract terms and prices that have been affected by the prior distortions of price controls and regulation. Some gas is priced below market, some above market. The long term goal is to eliminate these distortions and develop an efficient natural gas market. The issue is how to move from the current regime to this goal.

All three decontrol bills set the rules for this transition. Producers and purchasers will examine the impact that decontrol on January 1, 1993, has on their contracts. Much renegotiation will take place between the passage of a decontrol bill and January 1, 1993, to rationalize the operation of these contracts.

Answer 1 continued: After decontrol takes effect on January 1, 1993, gas markets will function more efficiently and rationally in sending correct price signals to consumers and producers. There will be low prices when there are plentiful supplies or low demand for gas. There will be higher prices when supplies are tight or demand is strong. Only if prices are permitted to rise when additional supplies are needed will we avert shortages by stimulating increased drilling and production activities.

Correct price signals are indispensable if natural gas is to effectively play its appropriate role in national energy policy: securing adequate supplies at competitive prices, providing a competitive, domestic alternative to imports of oil from insecure sources and providing an efficient energy option for meeting environmental goals.

The market is currently the predominant force setting prices of natural gas. It is sending fairly accurate signals to consumers on when to consume gas as opposed to when to consume oil, coal, or engage in conservation. It is sending

Answer 1 continued:

fairly accurate signals to producers on when to produce. The experience of the last several years in the gas market shows that it has been very responsive to supply and demand conditions (wellhead prices falling in the summer and rising in the winter).

If natural gas prices are decontrolled as proposed in H.R. 1722, S. 783, or S. 625, it will result in downward price pressure over the longer term. Thus, prices will be lower than they would otherwise be without decontrol. As discussed in question 2, many other factors will have a significant role in what the price of gas will be at any given point.

The downward pressure will result from two factors. First, lower cost reserves will be produced more efficiently under decontrol and thus postpone the production of higher cost reserves. This will result in prices lower than would otherwise be the case. Second, producers will be relieved from regulatory burden which would otherwise add to their costs. In a highly competitive market such as

Answer 1 continued: the current gas market, lower production costs will result in lower prices, all other things being equal. Given that many of the benefits of decontrol have already been realized by recent FERC actions, we would not expect the difference between decontrol and no decontrol to be dramatic.

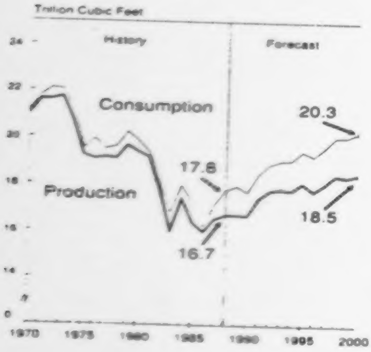
EIA forecasts prices to be $2.61 mcf ($1988) in 1994 and $3.76 mcf ($1988) in 1999. These forecasts do not include the impact of decontrol in the econometric model. Attached is an explanation of the assumptions of the forecast from the 1989 Annual Energy Outlook.

Natural Gas Markets

Upturn in U.S. Gas Consumption Is Expected to Continue

Consumption of natural gas increased during 1987 and again in 1988, to 17.8 trillion cubic feet, marking the start of a trend that is expected to continue through at least the next decade. The use of natural gas in the United States had generally been declining since 1973, despite small increases in some years, as the demand for gas dropped from about 22 trillion cubic feet in 1972, to 16.2 trillion cubic feet in 1986 (Figure 10). The recent turnaround in demand has been paralleled by domestic production. By 2000, annual consumption of natural gas in this country is projected to climb to about 20.3 trillion cubic feet, or about the same as it had been in 1979. But, production is projected to increase at a slightly slower rate than demand, with the result that net imports of gas will more than double to 2.3 trillion cubic feet by the end of the century. The natural gas contribution to total energy consumption is forecast to change little from the 23-percent level for 1988.

Steady Growth in Gas Markets



Source: See Appendix D.

Figure 10. Natural Gas Consumption and Production, 1970-2000

Electric Utilities Lead Rise in Gas Use, But Industry Remains Top Consumer

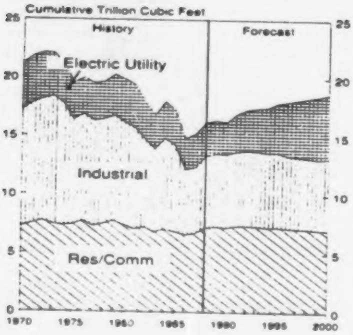
The electric utility sector accounts for virtually all of the projected rise in total consumption of natural gas, more than offsetting small decreases by the residential sector (Figure 11). Only very minor increases are expected in gas used by the commercial and industrial sectors (including lease and plant fuel). No change is expected overall for transportation uses (essentially, pipeline fuel). Gas-powered road vehicles are not expected to have any significant impact on total demand before 2000.

Industrial sector activities account for the largest share of gas used in this country -- 40 percent in 1988, including lease and plant fuel use (Table A9). The industrial sector will continue as the largest sector through 2000, although the industrial share will shrink to 36 percent. Total industrial use by 2000 is forecast to nearly match the 1988 level, reflecting the net outcome of two divergent trends: declining gas use in manufacturing activities and rising use in cogeneration activities.

Natural gas is the major fuel consumed in the industrial sector (Table A2). Its consumption of 7.2 trillion cubic feet in 1988 represented about 34 percent of all industrial sector energy consumption. About 1 trillion cubic feet of this was for lease and plant fuel consumption, while another 0.6 trillion cubic feet was used as a raw material, primarily for organic chemicals (particularly fertilizers). Most of the remaining consumption of natural gas was for heat and power in the manufacturing sector. Only smaller amounts are currently attributable to cogeneration of electricity in the manufacturing sector and for various uses in agriculture, construction, and mining. Despite the outlook for solid economic growth, a shift in demand away from those specific industries that use more gas and continued average efficiency gains with new investments over time point to declines in industrial demand for heat and power. Offsetting this decline, however, is an outlook for the increased use of gas to generate electricity both for self use and for sale back to electric utilities (see discussion on nonutility generation, page 26).

The electric utility sector is expected to be the fastest growing market for natural gas (Table A9). In 1988, electric utilities accounted for 16 percent of total gas use; by 2000, this share increases to 27 percent, as utilities displace the residential sector as the second largest user of natural gas. Strong growth in total demand is expected through the early 1990's, almost exclusively as a consequence of increased gas use in existing gas-fired plants by electric utilities. By 1995, utility use of gas will increase almost 40 percent, to 3.9 trillion cubic feet. Additional growth between 1995 and 2000 will be nearly as significant, as increasingly competitive natural gas pricing and the growing investment in combined-cycle generating technologies by electric utilities continue to push demand for this fuel upward. Between 1988 and 2000, additions of combined-cycle plants using natural gas come forward to meet 34 percent of the utility industry's total need for new generating capability in that period (Table A6).

Most New Growth in Gas Demand Seen Coming From Utility Sector



Source: See Appendix D.

Figure 11. Natural Gas Consumption by End Use, 1970-2000

Conservation, Competition Restrain Greater Residential Use of Gas

In the residential sector, natural gas consumption in 2000 is forecast to be 4.3 trillion cubic feet, about 6 percent lower than it had been in 1988 (Table A9). Its primary use in this sector is for space heating. Although natural gas currently accounts for about 50 percent of energy use by residential users (more than heating oil and electricity combined), the preference for electric-powered heating systems in new homes, the greater efficiency of new gas heaters, and ongoing upgrades of old gas systems all combine to restrain total demand growth for this fuel. For existing homes, gas furnaces undergo a normal replacement with age that currently can result in an upgrade of efficiency from around 50 percent to as high as 80 or 95 percent. This represents a continuing opportunity for the conservation of natural gas and particularly for conservation in the use of space heating fuels. Natural gas will still remain the largest energy source in the residential sector, but its share falls to about 46 percent by the year 2000.

In the commercial sector, natural gas use remains almost constant through 2000, at 2.7 trillion cubic feet. This constancy is the result of two offsetting trends. First, a growing share of new construction in total commercial floor space tends to increase the average intensity of natural gas use. (According to the EIA's 1986 Nonresidential Buildings Energy Consumption Survey, natural gas use per square foot of new commercial floor space is greater than use per square foot of older commercial floor space. The same is true for electricity.) However, offsetting this trend toward higher energy use intensities in new commercial space are the energy conservation effects that higher energy prices have on all commercial building projects – particularly through the increased efficiency of the existing primary heating systems. The effect of the projected 3.1 percent average annual growth rate in natural gas prices from 1988 to 2000 completely offsets the potential increase in commercial sector use of natural gas related to new construction.

Gas Markets Are Adjusting To Increasing Price Uncertainty

The long-term outlook for natural gas markets reflects a heightened competition among natural gas suppliers, as well as between natural gas suppliers and producers of alternative fuels. This increasingly competitive market structure is developing in response to (1) relative growth in the supply of gas not subject to price controls, (2) regulatory changes promoting the interstate movement of gas not directly owned by the transporting pipelines, and (3) the growing willingness of gas users to switch between energy suppliers. Hand in hand with the new competitiveness in natural gas markets is, of course, a growing uncertainty among market participants as to their future costs or revenues. Producers, transporters, local distributors, and consumers are all developing new marketing tools and strategies to cope with the increasing uncertainties and opportunities presented by a more flexible market.

Until recently, significant volumes of natural gas were sold under long-term contracts with inflexible pricing arrangements. Characteristic of today's market, however, is a greater reliance on spot sales, short-term supply agreements, and long-term supply agreements in which price terms are periodically renegotiated. Recently, intermediaries have introduced brokered forward contracts, offering a way to link sellers wanting a longer-term supply commitment and buyers interested only in shorter-term purchases, and vice versa. The planned startup of a futures market in natural gas would offer yet another tool for traders to minimize price uncertainty or, alternatively, to take advantage of short-term price movements.

Rather than abandon long-term contracting altogether, producers and consumers alike appear to be working towards the establishment of an optimal portfolio of contract vehicles. The intent here is to strike a balance between the risks of adverse price movements (or the outright inability to secure outlets for, or supplies, of gas) and the profit opportunities presented by advantageous movements. Concern about security of supplies may be especially important for suppliers with non-interruptible customers. This balance is different for all companies and will change over time along with current perceptions as to the direction and stability of the market. In addition to a mix of long- and short-term contracts, and greater pricing flexibility generally, this dynamic portfolio may include direct producer-consumer contracts, contracts with pipelines, and, for consumers and pipelines, also the ownership of gas resources.

The changing market environment is also reflected in the way participants are conducting their businesses. For producers, the excess deliverability capability (or bubble) that has hung over the interstate portion of the industry since 1982 is finally being diminished, as suppliers become more free to contract with buyers at market prices. The gas bubble, which has depressed wellhead prices for a number of years, is forecast to dissipate by 1990. However, with a less certain long-term outlook for the market under deregulation and a greater potential for wide seasonal swings in gas prices, it is possible that some level of excess deliverability will become a permanent albeit seasonal phenomenon, shrinking with peak demand in winters and building again in summers.

For producers, access to transportation and the ability to contract directly with consumers will also result in more rapid signals from the marketplace. Thus, any expectation that prices may rise, for example, would translate into an incentive to increase productive capacity and vice versa. Any excess deliverability that develops in natural gas markets in the near future, however, will likely be the result of unanticipated gas demand and will be corrected through normal market signals, unlike excess deliverability seen in the early 1980's which had developed in large part because of regulatory and contractual impediments to downward movements in price for gas sold into the interstate market.

New Competitive Context To Influence Relationship of Gas, Oil Product Prices

The analysis of changes in gas markets relative to other fuels is complicated because gas competes with coal as well as oil in the important industrial and utility sectors. In the near term, coal-use decisions are dictated largely by the existing capital stock, with the result that competition between oil and gas is expected to dominate industrial and utility fuel choices through 1995. In the longer term, however, decisions about fuel substitution are influenced by relative capital costs as well as by fuel costs. As a result, competition between coal and gas is expected to become increasingly important after 1995 -- especially as electric utilities, faced by a need for additional generating capability, consider the economic advantages of natural gas-consuming combined-cycle plants. These plants are generally constructed on a much smaller scale (with lower capital cost) and require less time to bring into service (with lower cost and regulatory uncertainty) than competing coal-fired steam generating units. Smaller scale, nonutility generators of electricity, who will burn natural gas, are also expected to meet a growing share of the Nation's future electricity requirements.

As gas becomes more competitive, its price should track the energy-equivalent prices for alternative fuels more closely in end-use markets, although those alternative fuels will differ across consuming sectors and regions of the country (Figure 12). Nonresidential users of gas have demonstrated a new aggressiveness in negotiating price concessions and a greater willingness to switch to other energy suppliers when those concessions are not forthcoming. The ability of pipelines to offer lower prices to certain classes of consumers, the increased opportunity for producers and consumers to contract directly with one another, and the unbundling of services offered by interstate pipelines have enabled a more competitive market to develop. As a consequence, the average delivered price of gas has moved closer to the true incremental cost of production and transportation.

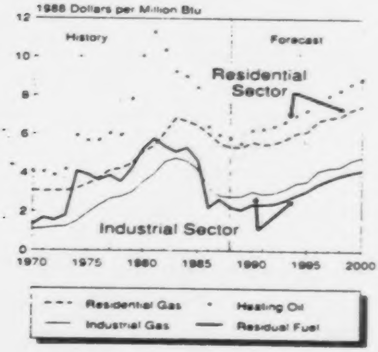
Even when comparing gas with directly competing fuels, precise pricing equivalence on the basis of Btu content should not be expected. In the residential sector, gas tends to be cheaper than heating oil on the basis of heat content, but in the industrial sector gas is generally more expensive than oil. Price differences for these competing fuels reflect relative convenience and some differences in supply risks, contracting practices (e.g., the interruptibility of gas delivery), and capital requirements related to consumption, storage, and environmental standards.

Gas Prices To Go Up Across the Board, with Imports Doubling by 2000

Demand for natural gas should continue to grow after 1988, and production, imports, and prices for this fuel will keep pace as well.

The average national wellhead price for gas (in 1988 dollars) is projected to increase from $1.62 per thousand cubic feet in 1988 to over $3.90 by 2000 (Table A9). Comparable, although slightly smaller increases are expected for each of the major consuming sectors, as the unit cost of transporting and distributing gas is projected to decline somewhat. On the high end, the average price of gas to residential users is forecast to increase from $5.50 per thousand cubic feet in 1988 to $7.70 in 2000. At the low end, electric utility gas prices grow from $2.25 per thousand cubic feet in 1988 to about $4.30. The growing importance of the utility sector over the forecast period means the average price of gas to all sectors increases by less than $1.90 per thousand cubic feet, to about $5.70 -- an increase that is four-fifths of the forecast increase in average wellhead prices.

Gas Expected to Track Oil Product Prices More Closely



Source: See Appendix D.

Figure 12. Delivered Prices for Oil Products and Natural Gas, 1970-2000

Continuation of the trends of direct producer-consumer contracting and unbundling of transportation services may mean that prices will increasingly reflect only differences in the type of services that consumers require.

Over the long-term forecast horizon, growth in U.S. consumption of natural gas will exceed growth in domestic production by nearly 1 trillion cubic feet, based on the gas prices discussed here. It is assumed in this forecast that most of this difference will be made up from increased net gas imports. Net imports are projected to grow from 1.15 trillion cubic feet in 1988 to about 2.3 in 2000. Most of these additional supplies will come as pipeline gas from Canada, although 0.3 trillion feet annually is assumed to come in the form of liquefied natural gas (LNG) imports, mainly to meet winter peaking requirements. The outlook for Canadian imports is assumed not to be influenced by that country's ratification of the Free Trade Agreement, since the Canadian Federal and Provincial governments have already taken significant steps to remove restrictions on the production and export of gas.

QUESTIONS FROM SENATOR JOHNSTON

Question 2: What factors other than wellhead controls (or the repeal of such controls) are likely to affect natural gas prices and supplies in the next decade?

Answer: Many factors affect the price of natural gas. In general terms, supply and demand will determine the price but many factors will affect supply and demand. Several factors affecting demand are oil, coal, and other alternative fuel prices, the rate of business activity (GNP), weather patterns, environmental regulation of gas or other alternative fuels, and inflation. Several factors affecting supply are the adequacy of the resource base, regulatory requirements, environmental policy, tax policy, and investment climate for other commodities.

QUESTIONS FROM SENATOR JOHNSTON

Question 3: What forces will operate to prevent a price "fly up" upon decontrol in January 1993?

Answer: Several factor will operate to prevent a price "fly up" upon decontrol. First, only a small percentage of natural gas will be subject to price controls in 1993. In fact, only 6% of current production is now effectively price controlled. This small amount will not significantly affect the price of the vast majority of gas that is already decontrolled.

Second, gas-on-gas competition and competition from alternative fuels will keep gas prices from flying up as a result of decontrol. Other factors such as those discussed in question 2 may result in higher or lower prices. But the impact of decontrol of remaining price controls should have little impact on average national prices. As noted in the question 1, there will be some downward pressure on natural gas prices as a result of decontrol.

Answer 3 continued: Third, given the current amount of effectively decontrolled gas and the current price being set by market forces, there is no indication that there are any kind of excessive demand conditions that would be necessary to produce a fly up of prices.

QUESTIONS FROM SENATOR METZENBAUM

Question 1:	You say in your opening statement that deregulation will send price signals that will encourage increased exploration and development. Doesn't that mean that dramatically higher prices will be the trigger for increased exploration?
Answer:	The market is currently the predominant force setting prices of natural gas. It is sending fairly accurate signals to consumers on when to consume gas as opposed to consuming oil, coal, or engaging in conservation. It is sending fairly accurate signals to producers on when to produce. The goal of deregulation is to address the few remaining distortions created by price controls and further improve market signals. Thus, wellhead decontrol may not result in an immediate increase in domestic drilling and production. It *will* result in more efficient consumption and production of lower cost supplies before higher cost supplies. Gas prices will send the appropriate signals as to when additional gas production is needed. Accurate, undistorted price signals will increase drilling when appropriate.

Answer 1 continued: There is no reason to believe that it will take "dramatically higher prices" to stimulate increased exploration and production. Each penny increase in the competitive price of gas will coax some supply response. In fact, the mere expectation that demand might increase and thereby raise prices is sufficient to cause producers to expand future production capability, thereby mitigating any dramatic increase in prices.

A recent DOE study establishes that there are significant quantities of natural gas that can be produced for under $3.00 per mcf. The purpose of the study was to determine both the extent of our natural gas resource base and its economic recoverability. The study was unique in that it was conducted by a panel of national renowned resource analysts.

The assessment shows that there is a technically recoverable gas resource base in the lower 48 states of 1,059 trillion cubic feet which compares to current consumption of about 18 tcf per year. More than half of the total resource evaluated for the lower 48, or 583 tcf of gas, was judged economically

Answer 1 continued: recoverable including finding costs at less than $3 per mcf in 1987 wellhead dollars. An additional 174 tcf of gas was judged economically recoverable in a price range of $3 to $5 per mcf. At 1987 levels of consumption, the Nation has a 35 year supply of natural gas at costs of less than $3 per mcf.

QUESTIONS FROM SENATOR METZENBAUM

Question 2: Do captive gas customers have to pay a premium over those prices to get secure, long-term supplies to be sure that they can heat their homes and businesses?

Answer: In a competitive market, market forces set a single price in any given production area. (Prices may vary by geography because of transportation costs). All buyers in that area will have the same competitive price available to them. Thus, prices do not reflect the elasticity of demand of the customer. Captive customers are offered the same array of prices as fuel-switchable customers.

Captive customers buy their gas by relying on the local distribution company (LDC) to either buy gas at the wellhead or from a pipeline's system supply. In either case, the captive customers rely on the State public utility commission to review the actions of the LDC. LDC willingness to pay a premium for long-term commitments because of State public utility commission policy is a matter of local concern.

Because of the regulatory distortions of the past, particularly the shortages created in the 70's by price controls, some captive customers

Answer 2 continued: do not yet trust that the natural gas market will work and believe that they must pay a premium for security of supply. They do not have the confidence that if supplies become tight prices will increase so that they will always be assured of supply. The last several years have shown that the market responds to surplus conditions by reflecting a low price for gas. When the market responds just as efficiently and rationally to tight conditions, buyers will develop confidence that the market will work and will not be willing to pay a premium for security of supply.

One reason captive, or even some large industrial customers, might pay a premium over competitive spot prices is to achieve a measure of price stability. The premium presumably would act as compensation to the other party for bearing the risk inherent in that type of guarantee. The experience of the gas industry

Answer 2 continued:

over the past 15 years, however, suggests that such contract arrangements may have been of dubious benefit to any party.

QUESTIONS FROM SENATOR METZENBAUM

Question 3: What in your opinion are the four most important steps D.O.E. should take to promote the efficient use and cost-effective conservation of natural gas? Since natural gas is such a premium fuel, shouldn't its efficient use be one of the Department's highest goals?

Answer: The "efficient use" of all fuels, not only natural gas, is one of the highest priorities of the Department. The most "efficient use and cost-effective conservation" of natural gas will result from reliance on market forces.

The most important step that DOE and the Congress can take is to eliminate the remaining distortions of wellhead price controls. This will result in low-cost supplies being produced before high-cost supplies. Higher-cost supplies will thereby be conserved until consumers demand their development.

The second step would be for the Federal Energy Regulatory Commission (FERC) to continue their impressive progress on perfecting open access transportation so that buyers and sellers can deal with each other directly.

Answer 3 continued: The third step would be for FERC to ensure that pipeline rate design is not creating unnecessary distortions in the availability of capacity.

The fourth step would be for FERC to streamline its pipeline certification procedures so that regulatory obstacles do not prevent additional capacity from being built when market conditions demand it.

These actions in the natural gas industry may result in greater demand for natural gas. This would benefit energy consumers nation wide. For every additional mcf of gas efficiently consumed, some other unit of energy was not otherwise consumed and is therefore conserved for future use. Additionally, energy prices in these other sectors will be concomitantly lower as a result of lower demand in that sector. Thus an efficient gas industry will result in interfuel competition that promotes conservation in all energy sectors. Additionally, market prices will send proper signals as to the efficiency of investing in conservation to minimize their consumption of natural gas.

Answer 3 continued: Higher gas demand and therefore higher prices must be looked at in terms of our total energy strategy. For example, allowing gas to be used in the generation of electricity will cause increased gas demand. This will increase gas prices but lower electricity prices. Conversely, prohibiting gas use for electricity generation will lower gas demand but increase demand for some other fuel that by definition was not more economic than gas (or else there would be no reason to prohibit gas use). This will result in lower gas prices, higher electricity prices and higher alternative fuel prices.

QUESTIONS FROM SENATOR METZENBAUM

Question 4: As of 1989, what percentage of sales gas in this country is produced by each of the top ten oil companies? Are these figures increasing or decreasing over time?

Answer: Complete company-level data are not yet available for 1989 or 1988. The most recent data available are for 1987. For the purpose of examining trends, 1982 data are shown. Based on public disclosures contained in company annual reports to shareholders, the shares of annual U.S. dry natural gas production for each of the top ten U.S. oil producers are shown below. All production is on a net ownership basis.

Share of U.S. Dry Natural Gas Production
(percent)

Company	1982	1987	Change
BP America[a]	0.2	0.4	0.2
Exxon	5.8	4.4	-1.4
Arco	2.6	3.2	0.6
Shell	3.4	4.0	0.6
Texaco	4.4	4.5	0.1
Chevron	2.4	4.3	1.9
Amoco	3.9	3.7	-0.2
Mobil	3.4	3.7	0.3
Unocal	2.3	1.7	-0.6
Sun	1.8	1.4	-0.4
TOTAL	30.2	31.3	1.1

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[a] Sales from natural gas production.

Source: Company production from annual reports to shareholders. U.S. total production from Energy Information Administration, Monthly Energy

QUESTIONS FROM SENATOR METZENBAUM

Question 5: As of 1989, what percentage of natural gas reserves in this country is produced by each of the top ten oil companies? Are these figures increasing or decreasing over time?

Answer: Complete company-level data are not yet available for 1989 or 1988. The most recent data available are for 1987. For the purpose of examining trends, 1982 data are shown. Based on public disclosures contained in company annual reports to shareholders, the shares of annual U.S. dry natural gas reserves for each of the top ten U.S. oil producers are shown below. All reserves are on a net ownership basis. In order to maintain comparability with published U.S. totals, downward revisions of Alaska North Slope natural gas reserves of Arco, BP America, and Exxon are excluded.

Share of U.S. Dry Natural Gas Reserves
(percent)

Company	1982	1987	Change
BP America	3.2	4.1	0.9
Exxon	8.2	9.9	1.7
Arco	7.2	7.6	0.4
Shell	3.6	3.5	-0.1
Texaco	3.1	2.6	-0.5
Chevron	2.5	3.8	1.3
Amoco	4.5	5.7	1.2
Mobil	3.1	4.1	1.0
Unocal	2.6	2.4	-0.2
Sun	1.6	1.2	-0.4
TOTAL	39.6	44.9	5.3

Source: Company reserves from annual reports to shareholders. U.S. total reserves from Energy Information Administration, U.S. Crude Oil, Natural Gas, and Natural Gas Liquids Reserves.

QUESTIONS FROM SENATORS CONRAD AND McCLURE

Question 1: If an action were proposed which could modify the Great Plains synthetic fuels production contracts so as to potentially adversely effect the project's economic viability, would the Department oppose such action?

Answer: The Department established the continued operation of Great Plains as a major policy objective guiding the divestiture process. This policy objective extends to our post-divestiture activities, following the Department's sale of the Great Plains Project under the Asset Purchase Agreement of October 31, 1988. The gas purchase agreements with the original partners were an integral part of the original Federal agreements on Great Plains financing. Both the future economic viability of the Project as well as a fair return on the taxpayers' investment through revenue-sharing are predicated on having the original partners fulfill the responsibilities they voluntarily undertook to purchase the output of the plant. Accordingly, the Department opposes actions which would modify the Great Plains gas purchase agreements in a manner which would adversely affect the Project's economic viability and the financial returns to the Federal Government under the Asset Purchase Agreement and related documents, including the October 31, 1988 letter from the Department to the Basin Electric Power Cooperative (attached).

QUESTIONS FROM SENATORS CONRAD AND McCLURE

Question 2: If an action were proposed which could modify the four agreements pursuant to such contracts to which synthetic natural gas produced by the Great Plains Synthetic Fuels Project is sold to the four major natural gas pipeline companies, would the Department oppose such action?

Answer: The four agreements for the sale of Great Plains production to the four major natural gas pipeline companies are the gas purchase agreements referred to in the Department's answer to the draft question No. 1.

We support the continuation of Great Plains sales of synthetic natural gas to the four pipelines in accord with the current contractual provisions. We would oppose modifications in such contracts, as indicated in the October 31, 1988 letter to Basin, referred to in response to Question No. 1.

QUESTIONS FROM SENATORS CONRAD AND McCLURE

Question 3: **In the judgement of the Department, could the natural gas legislation (S.625, S.783, or H.R. 1722) currently pending before the Committee either directly, or indirectly, affect the Great Plains synthetic fuels production contracts or the four agreements pursuant to which synthetic natural gas produced by Great Plains Synthetic Fuels Project is sold to the four major natural gas pipeline companies? If so, what could be the potential adverse effect?**

Answer: The Department is not aware of any provisions in S. 625, S.783, or H.R. 1722 which affect the contractual conditions in the Great Plains gas purchase agreements. The legislation does not abrogate or modify any contract.

To the extent that such legislation has impacts on natural gas and other energy markets, there is the potential for decontrol of wellhead gas prices to have an indirect effect on the actual prices which result from the complex formulae in the gas purchase agreements. However, it is not possible to quantify these effects or to isolate them from other market developments which could influence the future prices paid for Great Plains production.

QUESTIONS FROM SENATORS CONRAD AND McCLURE

Question 4(a): Currently pending before the Federal Energy Regulatory Commission is an April 3, 1989 proposed settlement agreement filed by the Transcontinental Gas Pipeline Company.

If the Transcontinental Gas Pipeline Company is successful in transferring its jurisdictional sales service obligation to its non-jurisdictional marketing affiliate, TEMCO, could this action directly or indirectly affect the Great Plains contract or its agreement with Great Plains?

Answer: The Dakota Gasification Company, to whom the Department sold the Great Plains Gasification Project, has expressed concerns that proceedings before the Federal Energy Regulatory Commission (FERC) regarding the Transcontinental Gas Pipe Line Corporation (Transco) could adversely affect the Project. The proceedings involve, in part, a restructuring of Transco's organization. Dakota is concerned that this restructuring could affect Transco's continued purchase of Great Plains production.

QUESTIONS FROM SENATORS CONRAD AND McCLURE

Question 4(b):	Similarly, could the action directly or indirectly affect the revenue stream from the Great Plains synthetic fuels project?
Answer:	Dakota has discussed these concerns with the Department. Because these concerns involve subsequent actions which Transco could take after reorganization, rather than the immediate effect of the restructuring, it is not possible to say definitively whether the reorganization would adversely affect, or even benefit, Great Plains.

QUESTIONS FROM SENATORS CONRAD AND McCLURE

Question 4(c): What action does the Department intend to take with regard to the pending FERC proceeding to both indicate its concerns regarding any direct or indirect effects of its action on the Great Plains Synthetic Fuels Project?

Answer: The Assistant Secretary, Fossil Energy, on May 12, 1989, sent a letter to FERC to reiterate the Department's general policy position and to request that the Commission, in acting on the Transco proceeding, ensure that its action would not adversely affect the regulatory and contractual framework on which the Great Plains project is premised.

FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D. C. 20426

OFFICE OF THE CHAIRMAN

May 15, 1989

Honorable J. Bennett Johnston
Chairman
Committee on Energy and Natural Resources
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Thank you for your letter of May 10, 1989, enclosing a set of questions for the record of the Senate Energy and Natural Resources Committee's May 8 hearing on pending natural gas decontrol legislation.

I am pleased to submit the enclosed responses prepared by Commission staff for your review.

If I can be of any further assistance, please do not hesitate to let me know.

Sincerely,

William Scherman

William S. Scherman
Chief of Staff

QUESTIONS FOR THE RECORD FROM SENATOR JOHNSTON

Question 1: What is the administrative cost to the Commission to administer the remaining NGPA wellhead price controls?

Answer : The Commission's Producer Regulation Program covers responsibilities under the Natural Gas Policy Act (NGPA) and the Natural Gas Act (NGA). The cost of the Producer Regulation Program is estimated at $8.6 million for Fiscal Year 1989 of which about 50%, or $4.3 million, is attributable to administering the wellhead pricing provisions of the NGPA. The Commission charges the first seller a fee for each well determination received by the Commission and expects to collect approximately $1 million in fees for well determinations in 1989. However, the net cost to the Commission for the Producer Program and all other Commission programs is zero since the Commission recovers all of its costs through fees and annual charges assessed and collected from the regulated companies.

Additionally, three other Federal agencies, the Minerals Management Service, the Bureau of Land Management, and the Bureau of Indian Affairs, currently serve as the jurisdictional agencies responsible for making NGPA well determinations for wells on Federal lands and incur administrative costs performing those duties.

Question 2: Are there also administrative costs to state regulatory authorities as a consequence of federal wellhead price controls?

Answer : Yes. There are 33 state regulatory agencies which serve as jurisdictional agencies responsible for making NGPA well determinations. Most of the state regulatory agencies increased their staff due to their duties as jurisdictional agencies under the NGPA. Some states assess a filing fee to recover the administrative costs associated with the determination process. As noted above, three federal agencies which currently serve as jurisdictional agencies also incur administrative costs as a consequence of federal wellhead price controls.

QUESTIONS FOR THE RECORD FROM SENATOR METZENBAUM

Question 1: FERC has issued two new rules, Orders 451 and 490, now being tested in the courts, that permit producers to raise the price of old, cheap gas, and unilaterally abandon their obligation to supply customers after expiration of contracts. Yet the Supreme Court has ruled more than once that producers have a Natural Gas Act obligation to continue to provide gas supplies to their customers upon contract expiration. How will Orders 451 and 490 insure the supply security that the Supreme Court ruled was Congress' intent in the Natural Gas Act? Why should producers now get to collect windfall profits on old gas that was profitably developed years ago?

Answer: Order Nos. 451 and 490 have been adopted to meet the changed environment in the natural gas industry that has resulted from Congress' enactment of the Natural Gas Policy Act of 1978 (NGPA). Order Nos. 451 and 490 are designed to enhance the nation's supply security, to further Congress' goals in enacting the Natural Gas Act (NGA) and the NGPA.

With respect to abandonment under section 7(b) of the NGA, once gas is "dedicated" to serve an interstate commerce customer, the producer cannot sell the gas to any other customers until the Commission finds that abandonment is required by the public convenience and necessity. Prior to the NGPA, the Commission concluded, and the Supreme Court upheld the Commission in cases like Sunray Mid-Continent Oil Co. v. FPC, 364 U.S. 173-153-55 (1960), that to carry out the NGA's purposes and goals of regulating the supply and price of natural gas, interstate service obligations should not be limited to the contractual term between the parties. Indeed, the Commission's rigid pre-NGPA abandonment rules were largely designed to prevent the movement of gas from the interstate market to the unregulated intrastate market, where the gas could command a higher price. Thus, as the D.C. Circuit recently noted, "In an energy market in which natural gas supplies were problematic and in which the unregulated intrastate markets threatened to swallow up large portions of those supplies, the abandonment provision served as a brake on the movement of gas out of the interstate stream." Consolidated Edison Company of New York, Inc., v. FERC 823 F.2d 630, 633 (D.C. Cir. 1987).

However, in enacting the NGPA in 1978, Congress significantly changed the method of achieving this desired objective by permitting market forces, to a very large extent, to regulate price and supply. As a result, the natural gas market has evolved into a nationwide market. Now, both interstate and intrastate gas consumers have equal access to new gas production without substantial price disparity. As the Supreme Court has stated, "The aim of federal regulation remains to assure adequate supplies of natural gas at fair prices, but the NGPA reflects a Congressional belief that a new system of natural gas pricing was needed to balance supply and demand." Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board of Mississippi, 474 U.S. 409, 421 (1986).

In Order No. 451, the Commission found that the former system of vintage rates for old gas was a "substantial source of market distortion causing producers to prematurely abandon easily accessible supplies, and consumers to react to misleading market signals based on chance historical costs rather than current economic efficiencies." FERC Statutes & Regulation ¶ 30,701 at 30,219. The Commission concluded that eliminating vintaging will substantially increase recoverable old gas reserves. Consequently, supply security will be increased by Order No. 451. Further, the new ceiling price is based on the replacement cost of gas which was found to be the just and reasonable price. Producers will not be receiving "windfall profits," but merely the just and reasonable price for the gas. As the Supreme Court recognized, since the enactment of the Natural Gas Policy Act of 1978, federal authority is expressed in a determination that rates should be unregulated and settled by market forces (Transcontinental Gas Pipe Line Corp. v. State Oil and Gas Board of Mississippi, 474 U.S. 409 (1986)).

In Order No. 490, the Commission concluded that the interstate service obligation should be limited to the contractual term agreed to by the parties. The Commission found that as a result of the changed conditions in the natural gas industry after enactment of the NGPA, continuation of the "service obligation after the contract has expired is no longer required by the public convenience or necessity because it prevents market forces from operating efficiently." Moreover, by permitting automatic abandonment, the new rule allows gas to move where it is needed, rather than tying it indefinitely to the dedicated purchaser who may have no current need for the gas. As the Commission noted, whether or not natural gas is dedicated to a particular customer does not impact the total gas supply available to the gas market as a whole. Dedication merely places restraints on the movement of gas. The new rule permits the gas market to operate more timely and efficiently by eliminating the need for case-by-case review when contracts terminate and the customers do not wish to continue purchasing. It has no effect on the total amount of gas available to the market as a whole.

Consequently, the policy embodied in Order No. 490 is that security of gas supplies is best assured when supplies are allocated as a nation-wide free market dictates. Continued regulation of gas prices interferes with the efficient operation of the market in allowing purchasers to contract freely to meet their needs for natural gas. If the market for gas were to tighten, the existing controls over gas prices would not alleviate the situation; instead, the ability of gas to be sold beyond its previously dedicated boundary would help alleviate the problem.

Finally, Order No. 490 does not change the pipelines' responsibility to meet their service obligations to customers under their certificates.

Question 2: If Congress were to pass a decontrol bill like the ones being considered today -- where producers are no longer required to request FERC-authorized abandonment of their obligation to serve -- doesn't that erode pipelines' similar obligation to serve its customers? Haven't the pipelines petitioned FERC for a regulation to allow them to abandon their customers unilaterally at the end of a service contract? Would this legislation bolster their argument?

Answer: Enactment of decontrol legislation would affect the wellhead gas market. Pipelines remain obligated to provide service to their customers up to their certificated level, until appropriate abandonment authorization is received under Section 7(b) of the Natural Gas Act. Also, as a result of the Natural Gas Policy Act of 1978, producer reserves that are currently subject to the Commission's Natural Gas Act abandonment jurisdiction are declining and thus serve a diminishing role in the pipelines' overall supply mix. Pipelines securing replacement from non-regulated supplies can tailor acquisitions with contracts ranging from spot market to long term to balance their customers' requirements.

The Interstate Natural Gas Supply Association of America (INGAA) has filed a petition for rulemaking which would establish a mechanism for the termination of sales service obligations under expiring contracts. INGAA argues that sales customers are using pipeline capacity for interruptible transportation of spot market supplies while preserving sales service obligations at unrealistic contract demand levels. Regardless of the matters raised in INGAA's petition, issues involving claims on a pipeline's capacity must be resolved in accordance with Section 7 of the Natural Gas Act.

Question 3: What has FERC done to encourage natural gas conservation? Have you required the utilities under your jurisdiction to develop least-cost plans, as many state regulatory commissions have done?

Answer: The Commission has been implementing policies and programs designed to remove impediments to the clear transmission of price signals between the marketplace and suppliers in order to achieve the most efficient allocation and use of our natural gas resources. Least-cost consistent with long-term reliable supplies is a significant factor in determining if proposed jurisdictional facilities are in the public convenience and necessity under section 7 of the Natural Gas Act as well as in determining whether proposed rates are just and reasonable under section 4 of the NGA.

Question 4: In your opinion what would happen to the retail price of natural gas for captive consumers the day after this legislation is signed into law, should that come to pass? What would happen to retail prices after five years due to this legislation?

Answer: Based on an EIA draft study, approximately 58 percent of the gas sold in 1987 was not subject to wellhead price controls. Through depletion of gas subject to price controls, that percentage is likely to grow each year. The draft study also shows that most of the gas still subject to price controls was being sold at prices below the ceiling price and that the price for less than 1 Tcf, or approximately 6 percent of all gas sold in 1987, is being restrained by a price ceiling. Put another way, 94 percent of all gas sold in 1987 was, in effect, price decontrolled. Therefore, as stated during the Committee's May 9th hearing, passage of S. 783, S. 625 or H.R. 1722 should have no effect on the cost of gas reflected in the retail price of natural gas, the day after the legislation is signed into law or five years after enactment.

Question 5: Commissioner Charles Stalon said recently that "through inaction, we have unduly enhanced the importance of the spot market." How will the decontrol legislation promote long-term and secure contracts?

Answer: Enactment of decontrol legislation will promote more competitive and efficient contracting decisions, because buyers and sellers will be able to choose freely among a greater variety of alternatives than under price controls. Buyers who value the security of a long-term contract will be free to seek those sellers who would be most willing to forgo spot sales in exchange for long-term contracts.

Question 6: Nearly two years after the Appeals Court ordered FERC to address take-or-pay, FERC has yet to issue a final rule for the courts to review. When do you expect the final Order 500 to come out? If FERC delays too long, and take-or-pay costs are already paid out by consumers, won't it be too late to unscramble the eggs? How will consumers get reimbursed if the final order is materially different than the interim order?

Answer: The Commission is currently analyzing the voluminous record in the Order No. 500 proceeding. The Commission intends to complete this process and consider a final rule in the Order No. 500 proceeding this year. In a final rule, the Commission possesses sufficient authority to make any appropriate adjustments.

Question 7: FERC issued a proposed rule several years ago expressing its opinion that very high incentive prices for certain gas were no longer needed and should be removed. Yet after comments from the industry, FERC took no action for 4 years, and then terminated the rulemaking rather than using its authority to deregulate this gas. If FERC is really promoting competition and "light-handed" regulation why doesn't it immediately act to remove these high price floors?

Answer: On April 7, 1989, the United States Court of Appeals for the District of Columbia, in Williams Natural Gas Co. v. FERC, No. 88-1079, directed the Commission to reopen the docket and reconsider the incentive price issue. Accordingly, the Commission is now considering what action to take in response to the Court's opinion.

SENATORS CONRAD AND MCCLURE

Question 1(a): Currently pending before the Federal Energy Regulatory Commission is an April 3, 1989 proposed settlement agreement filed by the Transcontinental Gas Pipe Line Company which would transfer its jurisdictional sales service obligation to its non-jurisdictional marketing affiliate, TEMCO. In such instances, what protection can the FERC provide long-term, above spot market contract producers in response to corporate reorganizations such as that proposed by Transcontinental Gas Pipe Line Company?

Answer: Your question relates to Article II of the April 3, 1989, settlement, which deals with gas supply and merchant service restructuring issues on the Transcontinental Gas Pipe Line (Transco) system. Since this is a pending matter before the Commission, the settlement is still under analysis and no formal determination on the legal and policy issues raised has yet been made. The Commission has, in such instances of service restructuring by natural gas companies, the general authority under the Natural Gas Policy Act and particularly the Natural Gas Act to determine whether the restructured service is in the public interest. In this particular instance, the settling parties have themselves asked that the Commission expressly determine that the interim merchant service to be performed by TEMCO is appropriate and lawful. Article II, section 3 of the settlement provides that if the Commission determines that the restructured merchant service must be performed by Transco on a jurisdictional basis, then Transco itself would implement the interim merchant service, on a jurisdictional basis.

Question 1(b): Could the proposed Transcontinental action directly or indirectly modify or abrogate the Great Plains production contract or the four agreements pursuant to which synthetic natural gas produced by the Great Plains Synthetic Fuels Project is sold to four major natural gas pipeline companies?

Answer : The question whether the April 3, 1989, settlement would unlawfully jeopardize the rights and revenues under the Great Plains Synthetic Fuels Agreements has been raised in a comment opposing the settlement, and is currently under review.

__Question 1(c):__ What protection will FERC provide the Great Plains Synthetic Fuels Project, in response to the corporate reorganization proposed by Transcontinental in its April 3, 1989, settlement agreement?

__Answer:__ As already noted, the settlement provides that the Commission shall determine whether the merchant service restructuring under the settlement must be performed on a jurisdictional basis by Transco itself, or may be performed by TEMCO. In addition, nothing precludes the Commission from taking any other action pursuant to its statutory authority as may be determined necessary. Summary rejection of the entire settlement, as requested by the commentor raising the issue of the Great Plains Synthetic Fuels contract, is one option to be considered when weighing the benefits and detriments that may flow to market participants under the proposal.

NATURAL GAS SUPPLY ASSOCIATION

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James A. Middleton
Chairman
Nicholas J. Bush
President
Patricia A. Hammick
Vice President

May 15, 1989

The Honorable J. Bennett Johnston
Chairman
Committee on Energy and Natural Resources
SD-364 Dirksen Senate Office Building
United States Senate
Washington, D.C. 20510-6150

Dear Senator Johnston:

In response to your letter of May 10, 1989, I attach hereto NGSA's answers to your and Senator Metzenbaum's additional questions relating to the May 8, 1989, hearing on S. 783, S. 625, and H.R. 1722.

Sincerely,

Patricia A Hammick
Nicholas J. Bush for

Representing the Nation's Producers of Natural Gas

NATURAL GAS SUPPLY ASSOCIATION
(NGSA)

NGSA'S ANSWERS TO ADDITIONAL QUESTIONS
RELATING TO MAY 8, 1989
HEARING ON S. 783, S. 625, AND H.R. 1722

QUESTION: Do any of the pending natural gas wellhead decontrol bills result in the abrogation of gas purchase contracts? In particular, is it contract abrogation where the repeal of wellhead price controls triggers the operation of a particular contract clause or where the repeal of wellhead price controls renders inoperative a contract clause that was premised upon the existence of wellhead price controls?

RESPONSE: NGSA does not believe that the decontrol bills under consideration by the Committee contain any provisions which would have the effect of abrogating existing gas purchase contracts between sellers and purchasers. The only existing contracts that would be impacted by gas decontrol before January 1, 1993, are those that expire of their own terms, are terminated by mutual agreement of the parties, or are modified by mutual agreement of the parties to permit the recategorization of the gas as decontrolled. (Under H.R. 1722 gas from new wells would also be decontrolled.)

Rather than causing contract abrogation, the pricing of gas after decontrol is explicitly provided for in the great majority of gas sales agreements which NGSA is familiar with. Most contain a so-called "deregulation" provision which clearly spells out how gas sold under a contract is to be priced if and when price deregulation of gas occurs. These "deregulation" clauses typically provide for either an automatic redetermination of such price based upon certain previously agreed objective criteria or for some form of price renegotiation opportunity for both parties. In the event the parties fail to agree to a renegotiated price, the gas is typically released from the contract on an unconditional basis. Even if a contract's pricing terms are undefined, once deregulation eliminates maximum lawful price ceilings, the contract is not abrogated. In all states except Louisiana, Section 2-305 of the Uniform Commercial Code provides that the price for the gas will be "a reasonable price at the time of delivery." It is likely that a reasonable price would be the deemed current market value for gas in the same geographical area and under a comparable type of sale (e.g., volume, time frame, etc.). While Louisiana has not adopted the U.C.C., it has incorporated this same principle into its common law.

QUESTION: Producers say that decontrol would encourage exploration and deliver supplies at reasonable prices. Aren't higher prices the only incentive for the stimulation of exploration and development?

RESPONSE: No, some level of exploration and development will occur at current prices. Generally, more new activity can be expected at higher prices. Through wellhead price decontrol, gas markets can signal the level of new activity desired.

Exploration and development of gas reserves depends on many factors, even though anticipated price is one of the most important factors. However, the oil and gas business is extremely capital intensive and requires long lead times to identify and develop prospects. Consequently, before investors commit funds to risky projects, they look for some assurance over the long haul of reliable markets at free market prices unimpeded by artificial regulatory constraints.

Regulatory constraints have created market-place distortions. For example, the producer must deal with abandonment, categories of gas, well filings, well determinations, and an overlay of regulatory and judicial uncertainty which makes it extremely difficult to determine whether the gas drilled for would command market prices. Prices then are not the only incentive for exploration and development -- the removal of price and non-price constraints is also desperately required. The market-place -- not well-intended regulatory programs -- must determine the price for gas.

QUESTION: What premiums in the way of price, take-or-pay obligations or other contract terms will producers need to sign long-term and secure supply contracts with pipelines, local distribution companies, or with end-users?

RESPONSE: In a free market, the market itself will determine whether and to what extent premiums are needed to secure long-term supply contracts. Generally, it is believed that long-term contracts will need to compensate the producer adequately at a premium over spot market prices to give the producer an incentive to commit supplies over the long-term. As between producers and pipelines, a gas inventory charge (GIC) will be necessary for pipelines to pass the payment of such premiums through to customers. Similarly, a GIC is necessary for the pipeline to pay the producer to perform under the gas sales agreement. A GIC should largely be a matter of negotiation between the pipeline and its customers and is determined by the market-place and what willing buyers and sellers negotiate.

Contracts producers enter into with local distribution companies (LDC) and industrial customers will similarly have to include a premium over spot to induce the producer to commit over the long-term. The premium in such an instance will most likely be called a reservation charge. Again, the specific amount of such premiums must be determined by the market-place at the time. We foresee that purchasers will request covenants that the supply will be there, and producers will want covenants that the purchaser has a firm commitment to pay the necessary premium to induce the producer to develop adequate reserves. Both parties will most probably want an indexing price formula with the negotiated premium added to such an index.

Other variables in addition to price which would be important to both the seller and the buyer would be the specific nature of the supply commitment (e.g., warranty, firm, best-efforts, etc.), the terms of the force majeure clause and the type of penalties associated with any non-performance which is not excused by the force majeure clause. All of these variables can be changed in any negotiation, but in the end both parties must feel that the economic benefits they derive under the deal adequately compensate for the level of risk and investment vis-a-vis other available investment opportunities.

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WM. C. ANDERSON
VICE PRESIDENT
POLITICAL AND LEGISLATIVE
RELATIONS

May 11, 1989

The Honorable J. Bennett Johnston
Chairman
Committee on Senate Energy and Natural Resources
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Danny Conklin has asked me to transmit these answers to the questions asked of him by you and Senator Metzenbaum.

I hope you find them helpful. Please let us know if we can be of further help.

Sincerely,

Wm. C. Anderson

Wm. C. Anderson

WCA/cmg

QUESTION FOR MESSRS' BUSH, CONKLIN, LAY AND SCHUSTERMAN

FROM SENATOR JOHNSTON

CONTRACT ABROGATION

Question: Do any of the pending natural gas wellhead decontrol bills result in the abrogation of gas purchase contracts? In particular, is it contract abrogation where the repeal of wellhead price controls triggers the operation of a particular contract clause or where the repeal of wellhead price controls renders inoperative a contract clause that was premised upon the existence of wellhead price controls?

Answer: In my opinion, as well as my lawyers, the answer is no. However, a number of producers appear to be confused in that these bills, in some instances, would trigger decontrol clauses. But that is not abrogation of the contract. In fact, it is the intended action of a contract. If the signators to the contract had not anticipated the likelihood of decontrol occurring during the life of the contract, they would not have agreed to such a clause in the first place.

The abrogation question is not as clear in H.R. 1722 as it relates to the "newly spudded" provision. Since that provision would cause new wells covered by an existing contract to be treated differently than existing wells under that contract, it could be argued that H.R. 1722 does partially abrogate some contracts.

QUESTIONS FROM SENATOR METZENBAUM FOR DANNY CONKLIN

Questions:

1. Producers say that decontrol would encourage exploration and deliver supplies at reasonable prices. Aren't higher prices the only incentive for the stimulation of exploration and development?
2. What premiums in the way of price, take-or-pay obligations or other contract terms will producers need to sign long-term and secure supply contracts with pipelines, local distribution companies, or with end-users?
3. Isn't the real reason that the price "fly-up" didn't occur upon partial deregulation on 1/1/85 merely that the dramatic price increases had already occurred between 1979 and 1982 when pipelines were signing contracts for 6, 7, even 10 dollar gas, with stiff take-or-pay requirements? Isn't another reason gas prices didn't increase in 1985 is that oil prices were already soft and putting downward pressure on gas prices?

Answers:

1. Not in this instance. Decontrol of old gas would release that gas back to the producer who not only would receive an uncontrolled price, but because of an end to non-price controls, would be able to sell his gas to whomever he chose rather than being forever tied to a single market. Likewise, because the decontrolled producer would know that if the price does go up sometime in the future he would be

eligible to get that higher price, he would be more apt to drill now than he would under continued certain controls.

2. No one knows for sure that long term contracts will ever be a fact of the future. During the past 5-6 years, most meaningful long-term contracts have been abrogated by purchasers or forced to be renegotiated, so most producers view long-term contracts as a one-way deal -- with producers always the loser. The FERC currently is investigating the possibility of some sort of gas inventory charge (GIC) as a way for purchasers to share the cost of assuring longer-term reserve supplies. I suspect this is a question which will be answered in an ever evolving manor -- constantly changing.

3. Those high prices offered in contracts between 1979 and 1982 were, as I recall, the reason some believed there would be a "fly-up" in 1985 -- that post-decontrol prices would automatically be triggered to those high referenced prices due to "most favored nations" clauses. No, the reason that there was no fly-up is that there was a surplus of gas which was the result of increased production due to higher prices, and lost markets due to alternate fuel competition. But the "fly-down" we actually experienced could not have occurred absent producers being willing to renegotiate contracts and forego take-or-pay entitlements -- a move they made to try to save and expand markets. Most important, however, is the fact that no one believes there will be either a fly-up or a fly-down if this bill passes.

INTERSTATE NATURAL GAS ASSOCIATION OF AMERICA
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May 12, 1989

Honorable J. Bennett Johnston
Chairman
Committee On Energy And Natural Resources
United States Senate
136 Hart Senate Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

Please find enclosed my responses to questions submitted by the Committee following the May 8, 1989, hearing on natural gas decontrol.

Respectfully,

Kenneth L. Lay
Chairman of the Board
Interstate Natural Gas Association
of America

GFJ/jl

Enclosures

Response of Kenneth L. Lay to Question of Senator Johnston

Question

Do any of the pending natural gas wellhead decontrol bills result in the abrogation of gas purchase contracts? In particular, is it contract abrogation where the repeal of wellhead price controls triggers the operation of a particular contract clause or where the repeal of wellhead price controls renders inoperative a contract clause that was premised upon the existence of wellhead price controls?

Answer

It is INGAA's belief that most natural gas purchase contracts contain clauses agreed to by the parties that provide for pricing of the gas in the absence of wellhead price regulation. Certainly in these cases it was intended that price decontrol would trigger the effectiveness of such clauses.

Some contracts may exist that assume the continuation of controls, but the decontrol bills before Congress to lift controls would not abrogate these contracts. One reason for delaying the date of decontrol until 1993 is to allow the parties in this situation time to renegotiate the contract and thus help avoid the problem. If the parties are unable to agree, then arbitration or litigation may be required to resolve the disagreement. In the worst case, one of the parties could raise a "force majeure" defense. Because no contract can encompass all potential circumstances, these avenues exist and are regularly used in situations such as this.

Responses of Kenneth L. Lay to Questions Of Senator Howard Metzenbaum

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Question

Will pipelines still have the same obligation to serve their customers when this bill would remove that obligation between producers and pipelines when contracts expire?

Answer

A pipeline's obligation to serve its customers arises out of the Natural Gas Act and is not affected by the removal of price controls from wellhead purchase contracts.

Question

Doesn't your organization have a petition pending at the FERC to remove pipelines' obligation to serve?

Answer

INGAA has submitted to the Commission a proposed rulemaking on the pipeline service obligation issue. We are not attempting to remove our obligations but rather to clarify them in light of recent FERC rulings.

Through a series of decisions over the last few years, the Commission has essentially removed the obligation of the local distribution company (LDC) to purchase gas from the interstate pipeline while making no corresponding adjustment in pipeline service obligations to the LDC. This situation puts pipelines in an impossible position, as they cannot maintain multi-year reserves of gas simply on the chance that an LDC on a given day may ask for its full entitlement of gas. This situation may also create a false sense of security if LDCs and regulators believe that pipelines can be forced to act as the supplier of last resort without being compensated to make the necessary purchases to serve in this capacity.

INGAA's petition proposes a restructuring of the service obligation to restore the mutuality of obligations that existed between pipelines and LDCs prior to the era of open access transportation. Whether our petition is noticed or not, this is an issue the Commission must face soon, for the current situation is untenable and threatens the future security of supply.

Page Two
Repsonses Of Kenneth L. Lay To Questions Of Senator Metzenbaum

Question

Unless a producer has large volumes of low-priced gas along with his above-market gas, why would it be in his interest to renegotiate his prices downward before final deregulation in January 1993 as proposed in these bills?

Answer

Circumstances vary greatly in the thousands of contracts between different pairs of pipelines and producers, making it difficult to comment with precision on this question. However, a producer with a contract priced at above market levels could have several reasons for renegotiating that contract. The pipeline, for example, may be taking that gas at relatively low levels and a price reduction might be accompanied with increased takes. Also, some pipelines are beginning to acquire additional reserves of gas for future needs, and renegotiation of current contracts could be included as part of a package for future reserve development. Finally, we understand a large number of contracts will expire prior to the 1993 date, rendering the renegotiation issue moot.

Question

The interstate pipelines still have the obligation to serve, you can't charge a minimum bill yet you still have take-or-pay obligations hanging over your heads, producers can abandon their service obligation to supply you with gas, and your cheap cushion gas is going to fly up on price. What's in this bill for the interstate pipelines?

Answer

In past years, INGAA supported comprehensive natural gas legislation that addressed those many issues. Unfortunately, Congress did not agree and the legislative process was deadlocked between the divergent views of conflicting industry factions.

The country and the gas industry needs a gas market where purchasers and producers send clear, unambiguous price signals between the burnertip and the wellhead. As we saw in the 1970s, price regulation will impede those signals with potentially devastating results. Continued price controls are particularly irrelevant in a market where much of the gas is decontrolled (and thus burnertip prices are market prices). In today's situation, the remaining controls protect few consumers but they do skew producer drilling decisions about what gas to search for or develop.

As we have painfully worked through the problems to which you refer over the last several years, we believe that the future for the natural gas industry and our consumers will be best served by a workable, free market.

A phaseout of remaining controls will remove distortion and improve stability in the market. To that extent, it benefits all segments of the industry, including consumers.

CHARLES SCHUSTERMAN

Questions and Answers - Senator Johnston

1. Under what NGPA price categories does your natural gas production qualify and how much of your production qualifies in each category?

Answer: The Samson Companies own and sell natural gas which qualifies under every NGPA category. As specifically concerning those NGPA categories for which price controls still apply, the Samson Companies own interests in Sections 103 (b)(1), 106 (b)(1)(B), 108, and 104 (all vintages, including flowing gas and minimum rate gas). While a substantial portion of the Samson Companies' gas production has been decontrolled, large portions are still subject to price control with respect to the categories previously described. The Samson Companies do not maintain records in a manner which allows an estimate of the quantities of gas applicable to each individual NGPA category.

- What prices are you currently receiving for your production?

Answer: Since the Samson Companies have gas in all NGPA categories which are still price controlled, the prices currently being received range from a low of $0.35 per MMBTU (for minimum rate gas) to a high of $3.42 per MMBTU (for Section 103 (b)(1) gas).

- How do these prices compare with the prevailing market prices in your area?

Answer: Most categories of price controlled gas sold by the Samson Companies require the gas be sold at prices which are substantially below prevailing market price. Only Section 103 (b)(1), Section 106 (b)(1)(B) and Section 108 gas is sold at prices higher than prevailing market prices. I should point out that in all instances where the NGPA price is less than the prevailing market price, the interstate pipeline companies are in compliance with their contracts while in virtually all cases where the NGPA price is greater than the prevailing market price, the interstate pipeline companies are not performing in compliance with their contracts by either paying a lesser price than allowed by the contract and by law or by not taking the prescribed quantities of gas pursuant to the take-or-pay provisions of the gas purchase contracts. In those cases substantial economic resources are being diverted from the exploration for new natural gas into legal fees.

- Do you receive the benefit of any federal tax credits for your natural gas production?

Answer: No

2. What is the duration of your gas purchase contracts and when do they expire?

Answer: The Samson Companies are parties to gas purchase contracts with termination dates ranging from the year 1990 to the remaining commercial life of the lease. With respect to the contracts under which gas is sold pursuant to price controls prescribed by the the NGPA, most, but not all, of Samson's gas purchase contracts expire in either the year 2010 or are in effect for the remaining productive life of the well.

3. Do your gas purchase contracts contain market responsive pricing provisions, *ie.*, market out clauses, and if so, have these contract rights been exercised by purchasers?

Answer: Many of the Samson Companies gas purchase contracts contain market responsive pricing provisions and in each and every instance those rights have been exercised by the respective gas purchasers. In addition, many of the Samson Companies' gas purchase contracts do not contain market responsive pricing provisions. These contracts were entered into many years ago in order to provide a predictable stream of income which the Samson Companies could then use to continue to either develop additional gas reserves or obtain bank financing. Prices paid under such contracts were never intended to represent the current market price. In virtually all instances where Samson financed borrowings utilizing gas reserves and the long-term gas purchase contracts, such borrowing capabilities have been reduced because the interstate pipeline companies have not performed according to their contracts. In those instances the Samson Companies have been forced to litigate and/or negotiate their contractual rights in order to receive the revenues upon which prior exploration decisions were predicated.

4. Do any of the pending natural gas wellhead decontrol bills result in the abrogation of gas purchase contracts? In particular, is it contract application where the repeal of wellhead price controls triggers the operation of a particular contract clause of where the repeal of wellhead price controls renders inoperative a contract clause that was premised upon the existence of wellhead price controls?

Answer: The Samson Companies believe that the interstate pipelines will use the decontrol bill to allege the pipelines are no longer obligated to pay prices which will

CHARLES SCHUSTERMAN

Questions and Answers from Senator Metzenbaum

1. What incentive does this legislation provide for independent producers to drill new wells?

   Answer: None

2. What are the prospects for independents such as yourself in the natural gas business? Is your ability to compete with the major oil companies improving or worsening over time?

   Answer: The collapse of both oil and gas prices has resulted in a lack of adequate funding for independents, such as the Samson Companies, to maintain drilling programs necessary to replace the resources being produced. This is because the combined effect of loan defaults and contract abrogations by interstate pipeline companies has caused the few remaining financial institutions who lend to independents in the oil and gas sector to lend less money. This lack of funding results in the independents are gradually going out of business by producing more reserves than they are replacing. As a rule, independents must sell their oil and gas reserves in order to pay expenses and cover debt service responsibilities, thus being forced to accept lower and lower prices. All of this combines to substantially decrease our ability to compete with the major oil companies and gas pipeline companies to whom the market power is swinging through both consolidation and the bankruptcy of their competitors. The passage of this decontrol legislation will serve to shorten this process and to insure that it is completed within a few years. This bill will hasten the day when gas production and transmission will be controlled by a handfull of very large and powerful companies in much the same manner that gasoline refining is now controlled by the majors. This will result in the ability of such giant companies to increase prices to the consumer in increments greater than their own increasing costs, thus widening profit margins after having put the competition out of business. In order to maintain the competitive posture of independents, further decontrol legislation is not needed. Rather, the rules should remain the same so that independents can develop the small reservoirs of gas which will be necessary to provide gas far into the next century. These reservoirs will not be developed by major oil companies. The independents are needed to maintain the honesty and integrity of the large companies and to insure that true competition results in the lowest price to the consumer.

be higher than the current market price for gas, even though there are no other pricing provisions in the contracts to the contrary. Likewise, in those instances where the contracts and the previously controlled prices are less than prevailing market price, the pipelines will insist that the contractual provisions do not allow for price increase to the prevailing market price. We know this because of similar claims which have resulted in litigation concerning NGPA categories which deregulated on January 1, 1985. At that time the same interstate pipelines made such allegations. The drilling of many new Section 103 (b)(1) wells was predicated upon the receipt of the NGPA published price for the remaining term of the contract based upon existing contractual provisions and the knowledge that the NGPA did not provide for the deregulation of such natural gas. In some instances the gas purchase contracts for such wells did not provide an effective mechanism for pricing subsequent to deregulation. Since the gas was forever price controlled by the NGPA it was not necessary to negotiate deregulation provisions into the gas purchase contract prior to the drilling of the wells and the expenditures of funds. For that reason a repeal of wellhead price controls may cause a "defacto" abrogation of gas purchase contracts, causing economics to be different than existed at the time the decision was made to expend funds to drill the related wells.

J. BENNETT JOHNSTON, LOUISIANA, CHAIRMAN

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United States Senate
COMMITTEE ON
ENERGY AND NATURAL RESOURCES
WASHINGTON, DC 20510-6150

May 10, 1989

Mr. Edwin Rothschild
Assistant Director
Citizens-Labor Energy Coalition
1300 Connecticut Avenue, S.W.
Suite 401
Washington, D.C. 20036

Dear Mr. Rothschild:

Thank you for appearing before the Committee on Energy and Natural Resources on Monday, May 8, 1989, to offer testimony on S. 783, S. 625 and H.R. 1722.

Enclosed are additional questions relating to the May 8th hearing. I would appreciate receiving your answers to these questions by Monday, May 15, 1989, so that we are able to continue our review of this legislation.

Thank you for your assistance.

Sincerely,

J. Bennett Johnston
J. Bennett Johnston
Chairman

JBJ/dfs

Enclosure

QUESTIONS FROM SENATOR METZENBAUM FOR ED ROTHSCHILD

IN YOUR TESTIMONY YOU STATE THE OPINION OF SEVERAL INDUSTRY ANALYSTS WHO ARE "BULLISH" ON THE FUTURE OF NATURAL GAS. DO YOU SHARE THEIR VIEW THAT DEMAND FOR GAS WILL INCREASE OVER THE NEXT FEW YEARS? WHAT CAN CONGRESS DO TO PROMOTE THE WISE USE OF NATURAL GAS AS A CLEAN FUEL, BUT THAT DOESN'T LET GAS DEMAND QUICKLY OUTSTRIP ITS SUPPLY?

THESE BILLS HAVE BEEN TOUTED AS "CONSUMER" BILLS AND AS "CONSENSUS" BILLS. TO YOUR KNOWLEDGE WERE ANY REPRESENTATIVES OF CAPTIVE CONSUMERS PARTY TO THE DRAFTING OF THE LEGISLATION?

WHAT IN YOUR OPINION IS IN THIS LEGISLATION FOR LOCAL DISTRIBUTION COMPANIES? FOR PIPELINES? WOULD YOU CARE TO SPECULATE WHY THEIR TRADE ASSOCIATIONS APPARENTLY SUPPORT THE BILLS?

citizen/labor energy coalition

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Washington Office

May 15, 1989

The Honorable J. Bennett Johnston
Chairman
Committee on Energy and Natural Resources
U.S. Senate
Washington, D.C. 20150-6150

Dear Mr. Chairman:

Enclosed are answers to the written questions posed to me by Senator Metzenbaum.

Thank you again for inviting me to testify on the gas decontrol issue, one which I know we have all spent many hours gritting our teeth over.

Sincerely,

Edwin S. Rothschild
Assistant Director

ESR/mg

Answers to Senator Metzenbaum's Questions for Ed Rothschild

1. I believe there is a concerted effort by the natural gas industry, led by the American Gas Association to increase U.S. natural gas demand. The effort underway is to not only maintain current gas markets, but open up new markets in areas such as co-generation and transportation. Moreover, as concerns about acid rain, ozone pollution and global warming increase, both government and industry are looking to natural gas as a way to reduce the pollutants produced by the burning of coal and oil. Based on these efforts, there is every reason to believe that demand for natural gas will grow over the next few years.

While it makes a great deal of sense to use natural gas in its most efficient manner and as a clean-burning fuel, Congress must be assured that America's large gas resource base will be efficiently transformed into available production. Because the natural gas producing industry is now dominated by the major oil companies and since they appear unwilling to expand their exploration efforts significantly unless oil prices rise above the $15 to $20 range (comparable to wellhead prices ranging from $1.50 to $2.00 per Mcf), U.S. proved reserves and production capacity will continue to decline. This means that in order to meet rising demand, more gas will have to be imported from Canada (where reserves and production are also dominated by major oil companies) and Algeria (in the form of LNG). It also means that during peak demand periods (winter heating season), U.S. production capacity may be insufficient to meet demand.

To insure that demand does not begin to outstrip supply, Congress must seek to improve the overall efficiency of energy usage, must prevent any delays in the drilling for gas on lands leased by the United States to gas producers, and must be prepared, in the event of supply shortfalls and the failure of the market, to properly allocate gas to its highest priority uses.

2. To my knowledge there were no representatives of captive consumers who participated in the drafting of decontrol legislation. Those who participated appear to have included representatives of producers, pipelines, investor-owned gas utilities, and large industrial consumers. Captive residential and commercial consumers who consume most of this nation's gas were completely and intentionally excluded from participating in drafting this anti-consumer legislation.

3. I cannot understand what benefits the decontrol legislation provides to local distribution companies. The legislation provides no protection from the FERC's arbitrary and irresponsible decision-making in the are of LDC bypass. The legislation also allows deregulated producers to abandon gas service, something which I understand some LDC's are now concerned about.

Interstate pipelines may have an interest in the legislation. Some of them are significant producers of natural gas and may have substantial volumes of "old" price-controlled gas.

Other pipelines, those with no production, are probably economically indifferent (they can pass all gas costs on to their consumers as can all pipelines and distribution companies) to the issue. Politically, however, they have more in common with their major suppliers than they do with consumers with whom they have no contact whatsoever.

I can only assume that leadership of the American Gas Association reflects the economic interests of its members and believes that decontrol and higher wellhead gas prices are needed by producers to provide the gas supplies that AGA members want to resell to consumers. As I stated in my testimony, it looks like a sweetheart deal for all involved with captive consumers picking up the tab.

AGA American Gas Association

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George H. Lawrence
President

May 15, 1989

The Honorable J. Bennett Johnston
Chairman
Committee on Energy and Natural Resources
United States Senate
Room 364
Dirksen Senate Office Building
Washington, D.C. 20510-6510

Re: Responses to Questions About A.G.A.'s Position on Wellhead Decontrol

Dear Mr. Chairman:

A.G.A. is pleased to respond to Senator Howard Metzenbaum's questions in conjunction with our testimony on wellhead decontrol. A.G.A. strongly supports wellhead decontrol upon the earlier of contract expiration, renegotiation, or January 1, 1993. As I testified before your Committee, and in previous hearings before the House Subcommittee on Energy and Power, we do not expect decontrol at this time to materially affect consumer prices. Further, although total and immediate decontrol upon the date of enactment could have increased take-or-pay accruals, the bills now being considered by Congress address this problem adequately.

A.G.A. is quite aware of the principal distinction between the House-passed bill, H.R. 1722, and S. 783 -- the "spudded" well provision. We are pleased that we can support either position and we hope the matter will be expeditiously resolved in conference. Now is the time to clear away the underbrush of remaining NGPA price celings.

As to the specific questions addressed to A.G.A., we are pleased to supplement our statement as follows.

1. **Since FERC's open access transportation program was established, have your member LDC's entered into many long-term supply contracts directly with producers, with the pipelines merely transporting rather than selling LDC's their gas?**

   There is anecdotal evidence that LDCs are beginning to enter into long-term gas supply contracts with producers for 30 percent-to-40 percent of their supplies. For example, a presentation by Bill McCormick, Chairman & CEO of CMS Energy, showed that the amount of LDC owned/committed gas in the supply mix clearly rose between 1980 and 1989 (chart attached). In another instance, the President of the Natural Gas Clearinghouse reported seeing "a sizeable shift from 30-day evergreen contracts for gas supply on the spot market, which accounted for 90 percent of his company's business last year, to multi-month and year supply contacts, which now account for 40 percent of the contracts" (Oil Daily, May 11, 1989).

   Importantly, the decontrol legislation now pending before the Committee does not adversely affect an interstate pipeline's contractual or NGA certificate obligation to sell gas, on a long-term basis, to LDCs. Service obligations, and the complex issues they raise, should be addressed expeditiously by the Federal Energy Regulatory Commission in individual certificate filings for sales service under a "gas inventory charge". A.G.A. recently prepared and hand-delivered to FERC a White Paper on this issue (copy attached).

2. **What percentage of the gas LDC's provide for their customers is spot market gas? What do you consider to be a long-term contract? Aren't you worried about LDC's reluctance to secure long-term and secure supplies? Are LDCs afraid to pay premiums to enter into long-term contracts?**

   Addressing each question in order, preliminary data for 1988 suggest that at least 27.7% of LDCs' supplies were under spot market contracts. There is, however, great variety in the volumes of spot market gas purchased by different LDCs -- some LDCs reported spot market purchases of only 2% of total supplies, while others reported that 78% of their purchases were from the spot market. Similarly, purchase patterns varied by geographic region -- from 7% of total suppiles to 50% of total supplies.

A spot market contract is generally defined as any contract to purchase gas for less than a year (in many cases, 30 days). A long-term contract is commonly thought of as a contract to purchase gas for more than one year. Such multi-year contracts usually provide for periodic price renegotiation. For example, a 5 year contract might provide for annual price redetermination.

Yes, A.G.A. is concerned that the relative lack of long-term supply contracts may have a detrimental effect on all segments of the natural gas industry. First, LDCs may be disadvantaged because they are exposed to more price volatility. Second, pipelines have reduced their reserves under long-term contracts (to ameliorate take-or-pay liabilities) but are still required to provide firm service under their NGA certificated sales service obligations and their firm sales contracts. And third, producers may be disadvantaged because they need long-term contracts to finance exploration, drilling, and production. We emphasize, however, that these problems do not mean a supply or deliverability shortage is emminent. A report by A.G.A.'s Gas Supply Committee, Natural Gas - Next Winter (November 1988) looked at this very issue. The report concluded that "on a national basis, no imbalance between supply and demand is expected" and, as forecast, none materialized. We do not expect material changes in this supply-demand scenario as a result of the enactment of decontrol legislation.

Regarding whether LDCs can pay premiums to enter into long-term contracts, a study by the National Regulatory Research Institute (the research arm of NARUC) suggests that LDCs can contract for long-term supplies, under certain conditions.[*] In order to sign long-term supply

[*] Natural Gas Producer-Distributor Contracts: State Regulatory Issues and Approaches (January 1988). Because of cost constraints, the study is limited to a review of just 28 contracts in a limited geogrpahic area.

> contracts LDCs need: (1) flexibility under state Public Utility Commission "least cost purchasing" plans; and (2) long-term, firm transportation rights on the interstate pipeline(s).
>
> Again, an LDC's ability to purchase long-term gas supplies at the wellhead is not adversely affected by the decontrol legislation that is pending before this Committee. Indeed, to the extent that the legislation enables or encourages pipelines and producers to reform their supply contracts the legislation could benefit LDCs.

The decontrol legislation now before Congress will enable producers to make better decisions about investments in gas exploration, drilling, and production. And, it will enable all three segments of the natural gas industry to better go about their business of serving customers in a less regulated, more competitive energy market. Decontrol will come at a good time -- as the nation's vast natural gas resource base, and its extensive delivery system, make more and more important contributions toward achieving national economic, environmental and energy security priorities. For these reasons, we continue to support wellhead decontrol, as framed in the pending legislation, and to work for its speedy enactment.

Sincerely,

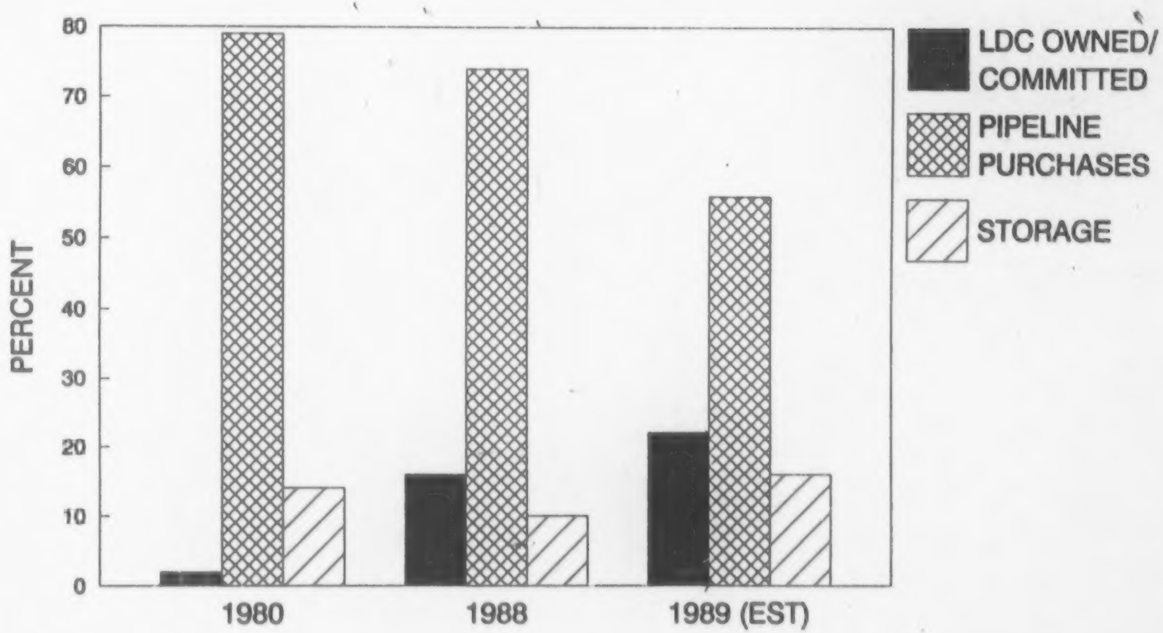
Bud Lawrence

George H. Lawrence

Attachment

cc: The Honorable James A. McClure
Ranking Minority Member
The Honorable Howard M. Metzenbaum

SHARES OF LDC SEND-OUT
(JANUARY)



NOTES

AGA American Gas Association

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George H. Lawrence
President

April 14, 1989

The Honorable Martha O. Hesse
Chairman
U.S. Federal Energy Regulatory
  Commission
825 N. Capitol Street.
Washington, DC 20426

Re: Interim Gas Inventory Charges

Dear Chairman Hesse:

I am pleased to provide you the American Gas Association's "White Paper on Interim Gas Inventory Charges." This White Paper is the product of our local distribution company and pipeline members' diligent efforts to develop a position on interim gas inventory charges. Our process included convening top gas industry executives for a series of face-to-face meetings in order to resolve the difficult issues inherent to this subject.

We are pleased to have reached a position, and to provide you the benefits of our efforts. We look forward to continuing to work with you on this and other issues facing our industry.

Sincerely,

G H Lawrence

George H. Lawrence

Enclosure

cc: Hon. Jerry J. Langdon
    Hon. Elizabeth Anne Moler
    Hon. Charles G. Stalon
    Hon. Charles A. Trabandt

A WHITE PAPER ON INTERIM GAS INVENTORY CHARGES

PREAMBLE

I.
Background

There is broad industry consensus that the concept of a permanent gas inventory charge is a good one, and further that permanent gas inventory charges should be considered by FERC expeditiously, as they are filed. This is not the case with "interim" gas inventory charges. Not all parties agree that interim gas inventory charges are necessary or appropriate. But, given the time it takes to develop and implement a permanent G.I.C., some pipelines will also need interim G.I.C.s. Such interim programs are obviously stopgap measures and are not intended to supplant permanent G.I.C.s. They should not consume the Commission's scarce resources and energies to such an extent that permanent inventory charges are delayed.

In this regard, if an interim G.I.C. policy statement in any way slows down the permanent G.I.C. process, it is likely to be more counterproductive than productive. Indeed, this "new" Policy Statement on interim G.I.C.s should not apply, in any way, to permanent G.I.C. filings or approvals.

A gas inventory charge potentially benefits all segments of the gas industry.

1. Pipelines providing firm sales service should be fairly compensated for the cost of standing-by to meet customers' nominated entitlements. Otherwise, they may be unable to continue in a merchant role.

2. LDC's should have viable transportation options and a current price signal for the full cost of pipeline sales service, rather than the cost uncertainty associated with lagged incurrence and recovery of indeterminate costs. This will improve supply planning and enable more accurate price signals to be sent to end-users.

3. Producers should also benefit from a GIC. If pipelines have a supply reservation cost recovery mechanism, pipeline-producer conflicts over take-or-pay and similar issues should abate, opening the way to new long-term contracts.

Despite the emergent consensus that the concept of a permanent gas inventory charge is a good one, progress toward the actual implementation of permanent gas inventory charges has been slow.

With the passage of time, the need to implement permanent G.I.C.s becomes more imminent. The longer that pipelines operate without a G.I.C., the greater the financial pressure to minimize their take-or-pay exposure by releasing reserves or canceling contracts, and the more difficult it becomes for pipelines to add long-term reserves to their supply portfolios. Aggregate statistics of proved reserves dedicated to interstate pipelines show that this is already occurring. Moreover, many pipeline sales service agreements are approaching expiration. Some pipelines have said that, unless they have a mechanism to recover the costs of maintaining reserves, they will seek sales service abandonment when these contracts expire. Prompt action on permanent gas inventory charges is obviously needed.

II.
Purpose of an Interim Gas Inventory Charge

In order to be useful at all, an interim gas inventory charge must be capable of being adopted expeditiously, based on filings and settlement offers that have substantial support from a pipeline's customers. Its purpose is to:

1). ameliorate a pipeline's take-or-pay accruals and, to some extent allow pipelines to make supply management decisions, during the interim period that the pipeline and its customers are resolving the many difficult issues that arise when developing a permanent inventory charge;

2). provide the LDC with assurances that its rights under expiring contracts will be preserved during these negotiations, as well as provide reliable transportation options.

Because the interim inventory charge is intended to be a "bridge" to a permanent program, neither pipelines nor their customers should be forced to make permanent or irrevocable decisions during the term of an interim G.I.C. Such decisions are properly left to the permanent G.I.C. and often involve its most important features, such as the abandonment of un-nominated sales service. Therefore, it would be inappropriate for FERC to require permanent abandonment of un-nominated sales service under an interim gas inventory charge.

However, it must be recognized that a future obligation to resume firm sales service, to a customer who has currently declined such service, creates serious supply-planning problems for a pipeline. Retaining current supplies in the event that a customer wishes to resume sales service at prior levels may entail substantial costs. Adding new supplies to meet future obligations -- including supplies for customers that may not nominate their full contract demand under an interim G.I.C. -- may be impossible. This is because the pipeline cannot know its future sales service obligations, until customers make decisions about whether to resume sales service in the future. Therefore, mechanisms must be constructed to manage the potential return of un-nominated sales service obligations. These mechanisms may involve a separate charge for supply "insurance" -- to defray the cost of retaining adequate supplies. They may involve a "ramp-up" provision, phasing-in the customer's right to resume full sales service over time. Standby sales service addresses this problem. Other provisions are equally appropriate. The mix of such mechanisms on a particular pipeline should be negotiated among the pipeline and its customers based on the magnitude of the problem. However, the Commission must recognize that, unless such mechanisms are in place, a customer's ability to rely on future sales service may be jeopardized.

III.

Synopsis of A.G.A.'s Position on Abandonment of Un-nominated Sales Service

Under A.G.A.'s proposal (as discussed below), an interim gas inventory charge would give customers the right to choose any one of the following options, or any combination of these options. First, a customer may nominate sales service under the inventory charge for all or a portion of its existing contract demand (CD). Second, it may choose temporary firm transportation, up to the amount of the un-nominated contract demand or if negotiated by the parties, standby sales service. Third, it may permanently convert any part of its existing contract demand to firm transportation.

Under the third option, the customer is deemed to waive the right to protest if the pipeline files for permanent abandonment of the underlying sales service, under NGA Section 7(b).

To the extent that the customer exercises option two for temporary transportation within un-nominated CD (and there is no standby sales service), the pipeline has limited term, but not permanent, authority to abandon sales service under our proposal. Because of this limit on permanent abandonmdnet authority during the interim period, the Policy Statment must permit pipelines and their customers to negotiate payment and other terms or provisions for any costs of un-nominated sales service. A.G.A. believes that this position strikes a reasonable balance. Customers are protected from permanent abandonment of sales service, arising under a temporary program, but because appropriate payment or timing mechanisms would be in place, the pipeline can plan for the potential resumption of un-nominated sales service in the future.

IV.
Flexibility and Case-by-case Implementation

Circumstances vary greatly from pipeline to pipeline. Therefore, gas inventory charges, whether permanent or interim, will need to be unique to each pipeline system, based upon its operating characteristics. The Policy Statement must give the parties as much flexibility as possible to address their own markets, supply areas, system configuration and other unique features.

In this regard, the Commission should not limit the parties' options by specifying a formula or formulas for any type of interim gas inventory charge, nor limit the design of an interim charge. It is simply impossible for FERC, or any entity, to design a pricing formula with nationwide applicability. Our ill-fated experiment with wellhead price controls, and 10 years of decontrol, should prove the unworkability of national or even regional price formulae.

Similarly, the Commission should not restrict the price formulae that can be selected. Specifically, spot market-based indices should be acceptable, as well as other indices, including (but not limited to) a price formula based on a weighted average cost of gas (WACOG). In addition, the policy statement should permit, but not require, the parties to retain a PGA mechanism.

CRITERIA FOR A POLICY STATEMENT ON INTERIM GAS INVENTORY CHARGES

1. Applicability: The criteria set out hereafter apply to interim gas inventory charges only. As was made clear in the preamble, the purposes of instituting a permanent G.I.C. and an interim G.I.C. are quite different. Nothing hereafter necessarily applies, or should be read to apply, to a permanent gas inventory charge.

2. Preconditions: Interim gas inventory charges should only be granted, pursuant to each of the criteria set forth herein, to open-access pipelines that have already filed, or will have filed, for a permanent gas inventory charge within 12 months of the time their interim G.I.C. takes effect.
   a. The Policy Statement should not require an open access pipeline to file for an interim gas inventory charge.
   b. The Policy Statement must not make an interim gas inventory charge a precondition for a permanent gas inventory charge.

3. Method of Implementation: The Commission should issue a proposed Policy Statement expeditiously. It should provided for a 30-day comment period, and the issuance of a revised final Policy Statement, based on comments received, within 60 days of the issuance of the proposed Policy Statement.

4. FERC Approval: The Commission should provide reasonable assurances for the speedy implementation of interim gas inventory charges. Widely supported offers of settlement should enjoy immunity from revisions by FERC or intervening parties who lack substantial, immediate interest. Prompt Commission action on interim G.I.C.s is necessary and delays are clearly harmful to the public interest. Therefore, the assent of the pipeline and a substantial majority of its customers (e.g. support from customers representing 75% of the pipeline's contracted sales entitlements) to either a filing or a settlement offer, should establish that such filing or settlement is in the public interest.

   The Commission's usual rules for offers of settlement would apply. Any customer that wishes to contest an offer of settlement by raising a substantial issue of disputed material fact should not be bound by the terms of the settlement.

5. Duration: An interim gas inventory charge should continue in effect for the shorter of two years or until the pipeline accepts a certificate for a permanent program. If the pipeline can not accept a permanent program by the end of two years, the pipeline must give 6 months prior notice and file: (a) for a one year extension; or (b) to reinstitute sales service, at levels equal to full contract demand for sales service less any permanent conversions to firm transportation. (Please see 7. below, discussing pregranted or expedited abandonment of sales service during the interim program.)

6. Discretion To Design Interim Inventory Charges: The Policy Statement should give pipelines that choose to file an interim program the option of applying for an NGA Section 7(c) certificate to implement a demand-based inventory charge; a deficiency-based charge; some combination of such charges; or other appropriate mechanisms.
   a. The pipeline and its customers shall negotiate a formula for the gas price and interim gas inventory charge(s). The Commission should not specify any formula for computing a demand-based, deficiency-based, or any other interim gas inventory charge. The precise form of the charge or charges should be left open to the pipeline and its customers, based upon their own market; supply; deliverability; and other criteria.

7. Sales Service Nominations: Recognizing the limited term and purpose of interim gas inventory charges, the Policy Statement should not subject interim G.I.C.s to the abandonment provisions in Section 2.105 of the Order 500 Policy Statement for permanent G.I.C.s. Instead, the Policy Statement for interim G.I.C.s should permit the following changes:
   a. Nominations of sales service under the gas inventory charge shall be freely permitted.
   b. Sales service nominations that are less than contract demand shall be treated as automatic limited term abandonments of sales service (to the extent of such nominated reduction and where no standby sales service is offered) and as automatic limited-term conversions to firm transportation.
   c. The limited-term conversions to firm transportation and limited-term sales service abandonments under 7.b. above, shall expire contemporaneously with the interim GIC, restoring pre-G.I.C. service levels.

d. Because the continuation of sales service obligations for un-nominated sales service may present supply-planning problems and/or costs for the pipeline during the interim G.I.C., the Policy Statement would permit the pipeline and its customers to negotiate provisions to ameliorate such problems and/or costs, including (but not limited to) separate supply insurance charges; standby sales service; ramp-up provisions phasing-in the return to sales service over a period of time; and any other provisions, charges or mechanisms agreed to by the pipeline and its customers.

8. Permanent Abandonment of Sales Service: Consistent with current regulations, the Commission will not allow pregranted or expedited permanent abandonment of pipeline sales service obligations that are in effect, at the time the pipeline implements its interim G.I.C., except where the LDC expressly agrees otherwise. Except that, where the LDC expressly requests permanent conversion to firm transportation, or expressly agrees to permanent abandonment, the LDC is deemed to have waived its right to protest if the pipeline chooses to file for abandonment of the underlying sales service, under NGA Section 7(b).

9. Pre-granted Abandonment of Firm Transportation Service: The Policy Statement would provide that while an interim G.I.C. is in effect on a pipeline there should be no pregranted or expedited abandonment of firm transportation service. Moreover, where sales service is converted to permanent firm transportation under the terms of the interim G.I.C., that service is not subject to pregranted or expedited abandonment at anytime, even including periods after the expiration of the interim G.I.C. As to firm transportation service that was converted from sales service prior to the time the interim G.I.C. becomes effective, the pipeline may agree, but is not required, to forego pregranted or expedited abandonment.
   a. The Policy Statement would not address the issue of pregranted abandonment of firm transportation service as it pertains to ongoing litigation, cases, or other filings at the Commission.
   b. The expiration of the contract should not relieve the customer of the obligation to pay for firm transportation service. If the underlying contract for firm transportation service expires, the price term of the expired contract shall continue to apply, unless and until the parties agree to a different price term.

c. A pipeline or customer would, of course, retain the option of seeking abandonment of firm transportation service, under NGA Section 7(b), at contract expiration.

d. The prohibition on pregranted or expedited abandonment of expired firm transportation service in 9. (above), and the terms for retaining such service in 9.b. (above), applies to firm transportation service pursuant to both NGA Section 7(c) certificates and the contract demand conversion provisions of 18 C.F.R. 284.10.

10. Refunds: The Policy Statement would permit (but not require) a pipeline and its customers to establish true-up or reconciliation provisions. The terms of any such provisions would be negotiated by the parties.

11. D2 Nominations: The Policy Statement would permit a pipeline and its customers to negotiate an interim gas inventory charge that suspends the D2 nomination process. Therefore, it would be permissible (but not required) for an acceptable offer of settlement to amend or alter D2 nominations.

TRAVIS & GOOCH

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GORDON GOOCH

May 15, 1989

SENATE COMMITTEE ON
ENERGY AND NATURAL RESOURCES
RECEIVED
MAY 15 1989
WASHINGTON, D.C. 20510

The Honorable J. Bennett Johnston
United States Senate
Committee On Energy
and Natural Resources
364 Dirksen Senate Office Building
Washington, D.C. 20510-6150

Dear Senator Johnston:

Receipt of your letter of May 10, 1989, is acknowledged. The answers to the questions posed to me by Senator Metzenbaum are set forth below. Before turning to the answers, allow me to express again our appreciation to you and to the Members of the Committee for the opportunity to be heard on May 8, 1989.

Question 1:

If demand for gas increases for all the reasons detailed here today, would large industrial consumers be willing to be curtailed on cold winter days in favor of residential consumers, shoools, and hospitals, or would the industrials bid up the price against captive consumers until adequate supplies come to the market or the weather moderates?

Accepting the assumption that demand for gas will increase for the sake of responding to your question, I am pleased to respond. As to whether large industrial consumers would be willing to be curtailed on cold winter days in favor of residential consumers, schools, and hospitals, the answer in my opinion is "yes", leaving aside the inevitable anomalous minority in any group. Even if there is a "Scrooge" who would answer in the negative, the laws and regulations are basically in place to achieve the result we would both wish. These include both the interruptible service provided to some industrial uses, uses that are curtailed as needed, and the curtailment priorities incorporated in the tariffs of the interstate pipelines and similar plans adopted by State regulatory authority, supplemented by the emergency powers of the State and Federal Governments.

Having answered the first part of the question in the affirmative, it follows that the answer to the second part is in the negative. I would like to supplement this by saying that industrials are also found in the class of "captive" consumers. Just as some local distribution companies are dependent on one pipeline, so may an industrial be dependent on one pipeline or on one distributor.

Question 2:

What is the average gas price that large industrials pay at the "factory gate"? What about residentials at the burner tip? What accounts for the difference?

As an illustration of, and answer to, the question presented, may I again refer to Table 4, "Selected National Average Natural Gas Prices" in the Energy Information Administration's Natural Gas Monthly (published in April, 1989). That table indicates, using the referenced methodology, that the following were the prices delivered to consumers in the following classes, for January, 1989 and for 1988:

Delivered Prices	Jan. 89 $/Mcf	Jan. 88 $/Mcf
Residential	5.42	5.46
Commercial	4.87	4.63
Industrial	3.36	2.96
Electrics	not available	2.34

It is my belief that the following accounts for a significant part of the differentials between the average prices paid by residential consumers as compared to industrial consumers, whatever the actual differentials are.

First, there is the distinction between firm and interruptible service that sometimes, but not always, is reflected in the rates paid to the middlemen for gas. A "firm" customer, such as a residential and some industrials, is supposed to be guaranteed service at whatever level is required 365 days a year. In contrast, an "interruptible" customer is not guaranteed service any day of the year and, in fact, expects to be curtailed whenever firm customers' demands need to be met. To the degree that this distinction is reflected in rates at both the federal and state level, one would expect the industrial average to be less than the residential average, since significant volumes of interruptible industrial load should be expected. Indeed, this interruptible load, served during the warmer months, allows the capacity of the systems to be more fully utilized, thereby lowering the average cost to the residentials.

Second, there is the fact that the facilities required to deliver gas to residential consumers, street by street, throughout a wide area are generally more substantial than the facilities required to deliver gas to industrials, and costs should be allocated to the customer classes acccordingly. Allocation of responsibility for costs among customer classes is often a litigated issue at the state level and sometimes at the federal level. In general, however, no distinction is made at the federal level among classes of sales for resale customers in setting the wholesale commodity rate at the city gate. Under current rate methodology, there is some cost shifting among sales for resale customers in order to subsidize those LDCs who do not have as much industrial load as others do. Technically, this is the D-2 nomination or allocation process under the modified fixed variable rate design. That same rate design results in a subsidy for all sales customers by all transportation customers, as usually formulated by several of the interstate pipelines.

Third, firm industrials generally take at a higher load factor than do residentials. In other words, the industrials are more likely to be steady customers, while the residentials swing between high gas usage and low gas usage on a seasonal basis, depending largely on the temperature. When you consider that both fixed and variable costs have to be recovered from customers, in general, the higher the load factor, the lower the unit cost. As a rough illustration, assume that monthly parking in a car lot or garage costs $100. One customer parks every day; the other customer parks every other day. The "average" cost of daily parking for the latter is twice as high as the "average" cost of daily parking for the former. Figure 3 in the referenced report graphically illustrates this point.

Fourth, there are certain costs that relate to service to customers, rather than to customer classes. Again, these individual customer costs are likely to be more significant on a unit basis for smaller customers than for the larger customers. Meter reading is an example. Please assume that the cost is the same for each meter, hypothetically. For one customer the cost is spread over 1,000 units; for another the cost is spread over 100,000 units. The result is obvious.

Fifth, there is the fact that local distribution companies, in some cases, are providing transportation and/or sales service that includes a lower unit cost of gas than that for system supply for firm customers. This would be in addition to the local distribution company securing transportation service on interstate pipelines to obtain gas supply for all of its customers at a lower cost than that available from the interstate pipeline.

Sixth, there is the fact that some industrial and even some residential consumers are direct sales customers of interstate pipeline companies i.e., the gas flows from the pipeline directly to the customer without going through a distribution company. This volume is relatively small nationwide. To illustrate this point, please refer to Table 13 in the referenced report. You will please note that for January 1989:

Pipeline Sales to:	$/Mcf
Industrials	2.80
Other ultimate consumers	4.83
Sales for resale (to LDCs and other pipelines)	3.32

The differentials here may be explained in part by the fact that the Natural Gas Act does not vest jurisdiction in the FERC to regulate the rates charged to direct customers of interstate pipelines. The Commission does, however, mitigate this somewhat by allocating costs away from the "jurisdictional" consumers.

Seventh, there is the fact that some industrials may be able to secure transportation service on interstate pipelines and obtain a lower cost of purchased gas on a spot or interruptible basis, although the industrial, under the current FERC rate methodology, is subjected to a rate higher that the non-gas commodity rate of local distribution companies in the same rate zone. The pipeline may choose to discount the rate.

While I am not sure that I have adequately covered all of the variables, I believe that the basic points are made that, in general but not universally, the industrial rates are lower because: some of the service is "interruptible" when gas is needed by the firm customers, including the residentials, and thus the inferior service carries less of a rate than the superior service; it costs less to build and maintain facilities to serve the industrials at retail, and thus less costs are allocated to the industrial rates; the load factors for industrials are generally higher, leading to a lower "average" cost, the individual customer service costs less on average; some LDCs are cooperating with industrials to secure alternative gas supplies so that the industrial can remain competitive in its markets; some industrial service is secured directly from interstate pipelines, sales and transportation with only "wholesale" costs involved; or combinations of the above.

I am sure that it is understood that this response reflects my own views and not necessarily the views of the organizations that associated with the written testimony delivered on May 8, 1989.

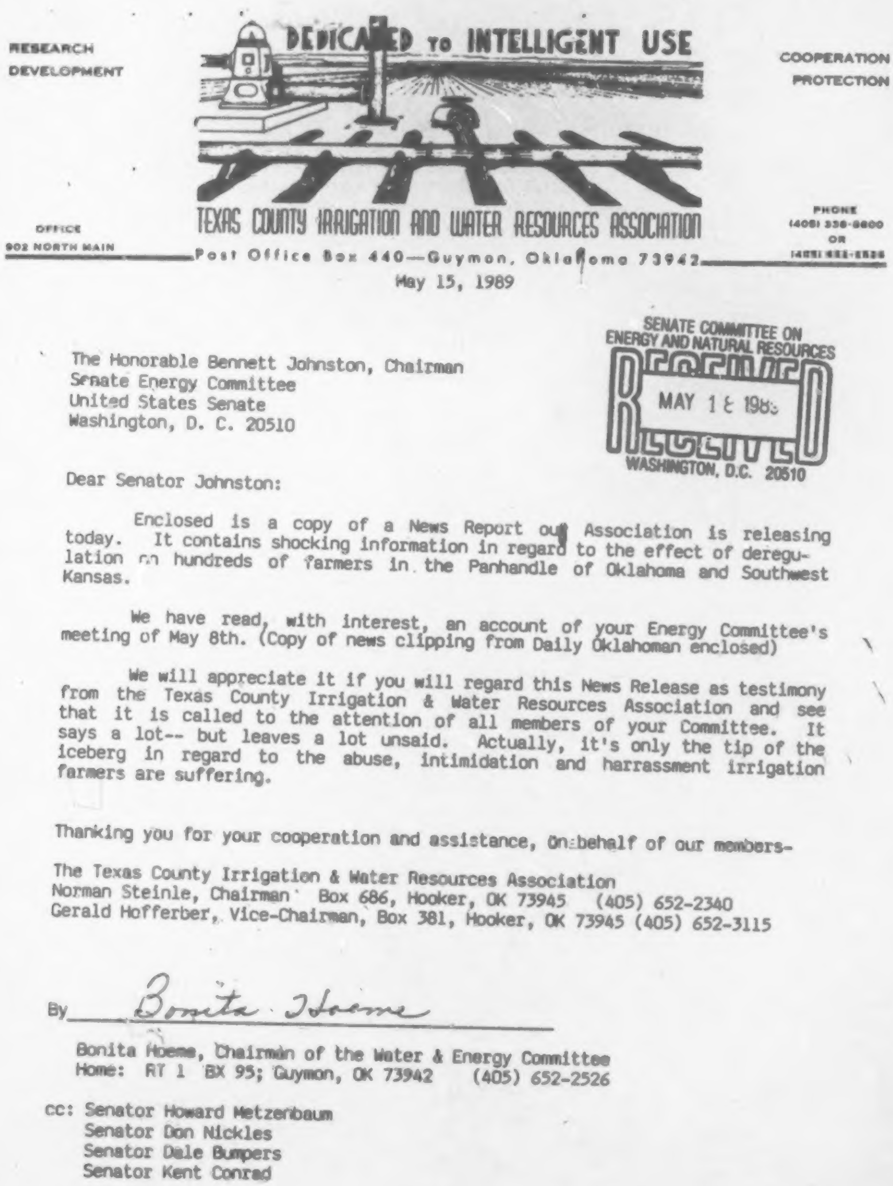
Very truly yours,

Gordon Gooch

Gordon Gooch

APPENDIX II

Additional Material Submitted for the Record



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902 NORTH MAIN

TEXAS COUNTY IRRIGATION AND WATER RESOURCES ASSOCIATION
Post Office Box 440—Guymon, Oklahoma 73942

PHONE
(405) 338-6600
OR
[illegible]

May 15, 1989

SENATE COMMITTEE ON
ENERGY AND NATURAL RESOURCES
RECEIVED
MAY 16 1989
WASHINGTON, D.C. 20510

The Honorable Bennett Johnston, Chairman
Senate Energy Committee
United States Senate
Washington, D. C. 20510

Dear Senator Johnston:

Enclosed is a copy of a News Report our Association is releasing today. It contains shocking information in regard to the effect of deregulation on hundreds of farmers in the Panhandle of Oklahoma and Southwest Kansas.

We have read, with interest, an account of your Energy Committee's meeting of May 8th. (Copy of news clipping from Daily Oklahoman enclosed)

We will appreciate it if you will regard this News Release as testimony from the Texas County Irrigation & Water Resources Association and see that it is called to the attention of all members of your Committee. It says a lot-- but leaves a lot unsaid. Actually, it's only the tip of the iceberg in regard to the abuse, intimidation and harrassment irrigation farmers are suffering.

Thanking you for your cooperation and assistance, On behalf of our members-

The Texas County Irrigation & Water Resources Association
Norman Steinle, Chairman Box 686, Hooker, OK 73945 (405) 652-2340
Gerald Hofferber, Vice-Chairman, Box 381, Hooker, OK 73945 (405) 652-3115

By Bonita Hoeme

Bonita Hoeme, Chairman of the Water & Energy Committee
Home: RT 1 BX 95; Guymon, OK 73942 (405) 652-2526

cc: Senator Howard Metzenbaum
Senator Don Nickles
Senator Dale Bumpers
Senator Kent Conrad

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FINAL DRAFT

FOR IMMEDIATE RELEASE: May 15, 1989

Oil Companies and their supporters in Congress are gleefully forecasting complete DEREGULATION OF NATURAL GAS PRICES before the first of June. It passed the House on a voice vote and is now on a fast track in the Senate. Its next appearance will be on May 17th.

A non-profit organization of farmers, officing in Guymon, OK. known as the Texas County Irrigation & Water Resources Assn., Inc. (TCIWRA) is asking the Media to publicize what happened to them as a result of partial price decontrol-- and to help them inform the public of the ramifications of total deregulation.

"It's late, but not too late to let the people know what is about to happen to them if natural gas is deregulated," says Norman Steinle, Chairman of TCIWRA.

"Several hundred farmers in the Oklahoma Panhandle and Southwest Kansas already know because they are grim proof that Oil Companies WILL RAISE PRICES DRAMATICALLY when decontrolled! Our story is one of horror and nightmare. It should be publicized.

"As a result of FERC Order #451, which allowed only partial decontrol-- the rate for irrigation TRIPLED IN JUST ONE DAY!

"So far as we are able to determine: THIS IS THE LARGEST RATE INCREASE EVER LEVIED ON ANY GROUP OF CONSUMERS ANY WHERE, ANY TIME, IN ONE DAY--WITH NO NOTICE AND NO HEARING.

"There are other ways we would prefer to make the Guiness Book of Records," said Steinle.

"The effect of tripling our rates is to allow Oil Companies to confiscate whatever profit would have accrued to our hard work, investment and RISK," says Bonita Hoeme, Chairman of the Water & Energy Committee of TCIWRA, "and they received this huge ADDITION to their PROFITS--with no increase in their cost of production. The huge rate increase is a direct benefit from deregulation to Oil Companies at great cost to farmers. Anyone who thinks Gas Producers are fighting for deregulation so they can LOWER prices is either naive or just plain stupid. They could lower prices WITHOUT DEREGULATION."

"Supplies & pricing of natural are in a state of chaos," she continued, "Big Oil is in the driver's seat, operating DUI--driving under the influence of Power & Greed. We need Mercy but would settle for Justice. They are giving us neither.

"One major Oil Company collects two to three times as much per MCF for irrigation gas, up front monthly, as they pay in cash to Royalty Owners for the same gas. They escrow royalty everything over 55¢ to 65¢ per MCF & hold it. Of course they pay interest on it--but they escrow that too. They have accumulated estimated millions of our money over the past year and a half. Some royalty owners may die while waiting for their payment.

"Another Oil Company is charging irrigators MORE than they charge any other customers. The Oil Companies do all the bookkeeping-- and we have to take their word for everything. So far as we know-- no one is auditing them. Their lack of accountability is a bad deal for us."

Jim Witt who farms 2000 acres and serves on the Water & Energy Committee warns, "Other consumers & the Senate Energy Committee need only to look at us to get a preview of things to come. It should scare them to death-- and we think it would-- if they had any idea of the fate about to befall them. They need to know so they can contact their Senators immediately.

"If Congress unleashes this Beast, it will rage about as a Roaring Lion, seeking whom it may devour. No one will ever be able to get him back into a cage again-- and no one will have any power to protect our citizens," Witt continued.

"With great power always comes great responsibility and Oil Companies have already proven in our case, that they simply cannot be trusted to handle that responsibility," Witt concluded.

Gerald Hofferber, Vice Chairman reports, "The argument FOR DEREGULATION is made that it will result in LOWER gas prices because it will create COMPETITION. Anyone who believes that should know that they spell competition, C-O-L-L-U-S-I-O-N and that's pronounced COLLUSION. If anyone thinks there is competition at the pumps--just watch how the price moves in unison-- and look how the price of gasoline has escalated at ALL gas pumps, regardless of which company name is on the pump-- just since Exxon spilled crude oil in Alaskan waters and devastated its beautiful beaches.

"The current Hearings in regard to DEREGULATION are reminiscent of the Hearings when Oil Companies, seeking to move into Alaska, down-played environmental concerns . Today they are reassuring the Congress that DEREGULATION will not result in HIGHER natural gas prices. We already know it HAS! And, if they aren't after HIGHER prices--why their fight for deregulation? It doesn't make sense.

"Deregulation is Decontrol--and Decontrol is NO CONTROL," Hofferber continued. "Are we ready for that? Why not take the issue to the people and ask them? If no one is left with any authority to help--where can an individual or a minority turn? We know that in our great country, there is Equal Justice for All-- but we also recognize that we do NOT HAVE EQUAL ACCESS TO THAT JUSTICE. Few have the resources to take on ONE Oil Company-- much less ALL of them--as they close ranks on an issue that would affect the oil industry as a whole."

Jim Witt brings up an interesting question, "With the price of natural gas increasing (in our case 200% to 300%)-- how will tripling or quadrupling its cost affect prices for many products purchased daily for home use by consumers? Plastics, food packaging, clothing, petrochemicals, tires and other household needs are products of hydrocarbon fractionization.

Witt makes an important point, "The current trend toward USE OF NATURAL GAS AS CLEANER FUEL FOR MOTOR VEHICLES is rapidly advancing. This brings great hope for improving our environment. Deregulation of natural gas NOW will position the Oil Companies to price Liquified Natural Gas on the basis of what the traffic will bear--rather than their actual cost plus a REASONABLE profit. A price as high as, or even higher, than gasoline will slow development of this wonderful opportunity for CLEANER AIR! It may not be generally known that many Gas Producers are the same Oil Companies that control gasoline "from the hole in the ground to the hole in the gas tank".

TCIWRA is concerned that the 300% increase in cost of irrigation gas was handed to Oil Companies as another WINDFALL PROFIT-- -- THEY HAD NO INCREASE IN THEIR COST OF PRODUCTION. They already own seven-eighths of the gas under our land--and they get it, just for producing it. They don't even have to pump it-- as they do oil.

Oil Companies do not pay surface owners for storing their oil and gas. . .and if the price does not suit them-- they can manipulate the price, simply by controlling the supply. All they have to do is just go on a type of "Undeclared Strike" by leaving the leaving the gas in the ground until the price is more to their liking.

Few Americans still believe in the "shortages" that occurred in the Seventies-- in light of the "surplus" that appeared in the Eighties. Every grammar school child knows that it takes thousands of years to form oil and gas-- so they know it didn't happen in that ten year interval. Small wonder that this Association questions the wisdom of trusting Oil Companies with the awesome responsibility of acting unselfishly when they have the tremendous POWER OF TOTAL DECONTROL. No one can stop them then.

All of the sacrosanct talk of not abrogating contracts is pure hogwash.

We are like Will Rogers. "All we know is what we read in the paper". Most of the information we have about what went on in Washington, D.C. comes from an article in The Daily Oklahoman, page 13 of the Tuesday, May 9th Edition. From it we glean that there were nine U. S. Senators present for a discussion in regard legislation to deregulate the price of natural gas. Our spirits are lifted by the report that Senator Metzenbaum is quoted as saying that the pending legislation "does not contain a single word, a single passage, a single sub-paragraph for natural gas consumers".

Senator Howard Metzenbaum, D-Ohio is further quoted as follows: decontrol measures represent an "Alice in Wonderland" scenario in which producers, pipelines and consumers all would be satisfied. He said the "burden of proof" that consumers wouldn't face a steep hike in gas prices if controls were lifted rests with its supporters. Unless that test is met, "I intend to oppose it," he said of the legislation.

TCIMRA NEWS RELEASE, page 4

The news article also reports, "Metzenbaum's comments came as two other Democratic members of the Senate Energy Committee- Sens. Dale Bumpers and Kent Conrad-- also said they would oppose lifting the remaining price restraints on natural gas if questions of a more parochial nature aren't answered."

The article also quotes J. Allen Wampler, the Energy Department's assistant secretary for fossil fuels, as follows: "There's nothing to lead us to believe ....there will be an upward trend in prices."

It seems, from this news article, that the main question on the minds of the Senate Committe was: Will DEREGULATION RAISE THE PRICE OF NATURAL GAS?

Perhaps Mr. Wampler did not know of our disastrous hike. We hope to inform him-- and ask him to change his testimony. Surely the 300% increase we got will "lead him to believe there will be an upward trend in prices."

The group assembled there need to know what happened to several hundred farmers out here.

If the Nation gets a steep hike in gas prices-- and that hike is translated into increased prices of all the many products derived from natural gas-- then it is entirely possible, even likely, that total deregulation would invite massive runaway INFLATION that may drive this Nation into the deepest economic and social depression in its history.

While Congress asks the question: Will Deregulation result in an INCREASE in natural gas prices? Our answer is, "IT WILL"

WE HAVE THE PROOF * * * * WE ARE THE PROOF

We wish the nine senators at that meeting would have discussed what has happened to us. Maybe J. Allen Wampler did not know-- but there was a MAN PRESENT AT THAT HEARING WHO DID KNOW and could have told them.

* * * * * * * * * * * *

THE DAILY OKLAHOMAN

Business Tuesday

● Livestock....16
● Rig Count....17

May. 9, 1989

Natural Gas Deregulation Hits Snag in Senate

By Ed Kelley
Washington Bureau

WASHINGTON — The speedy train on which deregulation of natural gas has been riding was slowed a bit Monday when Sen. Howard Metzenbaum, longtime nemesis of the oil and gas industry, announced he might wage a fight to ensure consumers are protected.

"I am in no hurry to pass this bill now, or if it comes to the floor of the Senate," declared Metzenbaum, D-Ohio, as the Senate formally opened debate on natural gas decontrol.

Metzenbaum's comments came as two other Democratic members of the Senate Energy Committee — Sens. Dale Bumpers and Kent Conrad — also said they would oppose lifting the remaining price restraints on natural gas if questions of a more parochial nature aren't answered.

The atmosphere during the three-hour hearing was civil, but not as friendly as similar sessions last month in the House, which approved its own decontrol measure with little rancor in committee and none when it reached the House floor, where it passed by voice vote.

Still, the Senate panel appears to favor decontrol, perhaps by a wide margin. Of the nine senators present Monday, at least six of them — including Sen. Bennett Johnston, the chairman — are decontrol proponents.

As for Metzenbaum, "I think he's going to try to obstruct the bill or amend it substantially," said Sen. Don Nickles, R-Ponca City, who is author of one of three decontrol measures. "I don't think he'll be successful."

A session to blend the three bills originally scheduled for Wednesday has been delayed

See GAS, Page 14

Howard Metzenbaum

Don Nickles

Gas

From Page 13

until May 17.

Metzenbaum has long opposed measures that would lift controls on energy, whether it be oil, gas or both. As a freshman senator, he led a filibuster in 1977 for nine days on the Senate floor against deregulation legislation. A year later, Congress approved legislation that would lift prices on some categories of natural gas by 1985. but kept them for others.

Monday, Metzenbaum claimed that decontrol measures represent an "Alice in Wonderland" scenario in which producers, pipelines and consumers all would be satisfied. He said the "burden of proof" that consumers wouldn't face a steep hike in gas prices if controls were lifted rests with its supporters.

Unless that test is met, "I intend to oppose it," he said of the legislation. The three measures before the Senate — mostly alike, except for a provision on newly started wells — "does not contain a single word, a single passage, a single subparagraph for natural gas consumers," Metzenbaum said.

Johnston, D-La., made a point of eliciting testimony from representatives of the Bush administration and the Federal Energy Regulatory Commission that lifting the remaining restraints would benefit — not harm — residential users of natural gas.

"There's nothing to lead us to believe ... there will be an upward trend in prices," said J. Allen Wampler, the Energy Department's assistant secretary for fossil fuels. While 35 percent to 40 percent of current gas supplies remains under regulation, only 6 percent or so is at a level above federally mandated controlled prices, Wampler said.

Charles Schusterman, chairman of Samson Investment Co. in Tulsa, said he and other small independents support decontrol in general, but worry that the bills authored by Nickles and others would send prices plummeting for producers once regulatory provisions are lifted under certain contracts.

Nickles, however, said the measures aren't intended to abrogate contracts now on the books.

NEWS RELEASE

NASUCA

National Association of State
Utility Consumer Advocates

1101 14th Street, N.W., Suite 808
Washington, D.C. 20005
(202) 727-3908

FOR IMMEDIATE RELEASE

FOR MORE INFORMATION CONTACT:

Margaret Ann Samuels (614) 466-9567
or Suzanne Davis (202) 727-3908

NASUCA Testifies Against "Old" Gas Decontrol

The National Association of State Utility Consumer Advocates (NASUCA) today filed testimony before the Senate Energy and Natural Resources Committee opposing S.783, a bill which would remove all price ceilings from natural gas still regulated under the Natural Gas Policy Act of 1978.

Margaret Ann Samuels, Chair of NASUCA's Gas Committee, and federal counsel for the Ohio Office of the Consumers' Counsel reiterated NASUCA's long term opposition to deregulation of old gas prices and warned the committee that "low cost (Section 104) gas still under contract to pipelines is likely to immediately rise in price to the highest price being paid in a given area." She stressed the deficiencies in the legislation by adding "there is nothing in the legislation that would allow renegotiation of high cost contracts to offset the effects of old gas decontrol."

Citing her office's and other NASUCA members' actual experience in litigating natural gas cases in contrast to the theoretical market-price goals of the legislation, Ms. Samuels added - last year gas producers released some low cost gas under contract into the spot market, while the higher cost gas under take-or-pay contracts was purchased for consumers. Under S. 783 this situation will continue.

NASUCA also challenged the argument that decontrol will benefit consumers. NASUCA acknowledged that higher prices resulting from decontrol would benefit "efficient" low cost gas producers but emphasized that these higher prices would flow through to consumers. NASUCA cited numerous instances wherein local distribution companies are still obtaining significant amounts of their gas supply from interstate pipeline sources - a fact which supporters of this legislation must be ignoring. Any increases in pipeline gas costs will therefore be passed through to residential customers.

NASUCA is comprised of 44 state designated agencies from 39 jurisdictions.

Written Testimony of the
National Association of State Utility Consumer Advocates
Regarding S.783

Before the Senate Energy
and Natural Resources Committee
May 8, 1989

The National Association of State Utility Consumer Advocates (NASUCA) is the organization of state agencies authorized by statute to represent residential and other small consumers of utility services in 38 states.

NASUCA, as you know, is on record opposing the repeal of price ceilings for "old" gas under Title I of the Natural Gas Policy Act (NGPA). NASUCA members are statutorily appointed to represent residential and other small consumers of utility services in nearly 40 states.

NASUCA's natural gas committee has been active in recent years in working to achieve gas transportation rights for local distribution companies and in opposing the administrative decontrol of old gas through Order No. 451 of the Federal Energy Regulatory Commission (FERC).

As chair of NASUCA's gas committee, I would like to address the impact of the proposed legislation on gas costs to consumers in states such as Ohio, Pennsylvania, Maryland, Indiana and Illinois as well as the District of Columbia. Consumers in these states and through the upper midwest and northeast are served by interstate pipelines such as Panhandle Eastern Pipe Line Company (Panhandle), Transcontinental Gas Pipe Line Company (Transco) and Columbia Gas Transmission Corporation (Columbia). These pipelines continue to have high gas costs affected by their contracts with producers. I and other NASUCA gas committee members have personally participated in numerous cases before the FERC involving these pipelines' gas costs and have reviewed their contracts. We also participate in review of gas purchases by LDCs under state regulation, and observe first-hand the effect of pipeline gas costs on the gas bills of consumers.

Our testimony will center on the actual impact on consumers as opposed to the theoretical or ideal effect of repeal of NGPA price ceilings on old gas. It will be based on our members' actual participation in cases, particularly mine as federal counsel for the Ohio Office of the Consumers' Counsel, as well as analysis of what LDCs are doing in some of our member states.

S.783 as written will remove all price ceilings on January 1, 1993 from natural gas that is still regulated under the Natural Gas Act of 1938 (NGA). The low cost Section 104 gas that is still under contract to pipelines will in many instances immediately rise in price to the highest price being paid in a given area under so-called "favored nations" provisions in the contracts. There is nothing in this legislation that would allow renegotiation of high cost contracts to offset the effects of old gas decontrol.

The actual producer-pipeline contract situation, as opposed to a theoretical market-price goal, should be a matter of concern to this committee. The Federal Energy Regulatory Commission (FERC) requested actual data from interstate pipelines to be submitted in late 1987 in connection with Order

No. 500. Since that time no word has been uttered to reveal the results of what was to be FERC's "prompt analysis." Both pipelines and producers insist on confidentiality of terms although FERC has the statutory authority to make them public.

In a hearing held last summer regarding Columbia's 1987 and 1988 purchases, it was found that take-or-pay and "must take" volumes in its contracts constituted well over 100% of its purchases, so that it released gas under contract into the spot market during the summers. In most instances it was the low-cost gas which producers agreed to release, while the higher-cost gas under take-or-pay contracts was purchased for consumers. This caused the average price of gas to be far higher than if Columbia had purchased available low-cost supplies. As low-cost gas is removed from the system, which S.783 permits, this situation will continue and worsen.

The statement is made that decontrol will benefit "efficient," i.e., low cost producers. This is certainly true, but it does not follow that it will benefit consumers. One of the arguably more "efficient" producers is Exxon Corporation. It is by far the largest supplier to Columbia. In 1987 Columbia purchased 25% of its non-Appalachian supplies (over 20% of its total) from Exxon under a contract which allows only Exxon to release the gas. Exxon is also a major supplier to Panhandle. As pipeline sales decrease, the percentage from this supplier is bound to increase. I suggest the committee examine these contracts to see whom it is benefitting and how.

S. 783 similarly would not affect the contract under which the Great Plains coal gasification plant provides gas to pipelines such as Tennessee Gas Pipeline Company (Tennessee) and ANR Pipeline Company (ANR) which must purchase its output and have approval to pass the cost through to consumers throughout the midwest and eastern states.

Significantly, these pipelines have joined in a brief to the U.S. Court of Appeals for the D.C. Circuit, filed two weeks ago, pointing out the "defective logic" in asserting that "the abandonment of low cost gas to pipelines would somehow result in lowering the average price of gas to consumers." They confirm NASUCA's position that a significant number of economic contracts remains unreformed and that substantial take-or-pay liability continues to build up under these contracts. Transwestern Pipeline Company, a subsidiary of Enron Corporation, is a signatory to that brief. Similar arguments were made recently to the Fifth Circuit in opposing FERC's administrative decontrol under Order No. 451.

Sponsors of the bill are apparently relying on the belief that local distribution companies (LDCs) can or do get practically all of their gas supply from sources other than interstate pipelines. This belief is not borne out by the facts.

It is true that most large LDCs are obtaining substantial portions of their supply through direct purchase and transportation and that the trend is continuing. But LDCs are informing FERC and their state commissions and advocates that they want their pipeline suppliers to retain their merchant function and provide reliable supply. In 1988 the following are representative figures:

COMPANY	STATE	CUSTOMERS	PERCENT OF SUPPLY PURCHASED FROM PIPELINE(S)
Cincinnati Gas & Elec.	Ohio	316,699	19%
Dayton Power & Light Co.	Ohio	250,000*	49%
East Ohio Gas Company	Ohio	937,000	33%
National Gas & Oil Co.	Ohio	17,754*	38%
Ohio Gas Co.	Ohio	28,510	21%
Pike Natural Gas Co.	Ohio	4,630	100%**
Waterville Gas & Oil Co.	Ohio	1,674	100%
Washington Gas Light Co.	D.C. Maryland Virginia	650,000*	43%
Columbia Gas Distribution	Kentucky Ohio New York Maryland Pennsylvania Virginia	1,900,000 (est.)	63%
Baltimore Gas and Elec. Co.	Maryland	519,000	38%

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* residential only
** Pike has now begun some direct purchases

This list includes companies which have been the most aggressive in diversifying their supply, as well as tiny companies with little resources to do so. It is clear that an increase in pipeline gas costs will affect all of them and the consumers they serve.

Much is made of the fact that gas prices did not continue to rise after January 1, 1985. Consumers and pipelines can tell you that that is because the "price spike" happened in 1982-1984, as gas decontrolled immediately by the NGPA began to be produced under the high take-or-pay contracts. It is true that gas prices have come down since then but it is not true that this is due to decontrol. It is because the gas prices under existing contracts had become unmarketable and pipelines were forced to renegotiate the uneconomic contracts at great cost. Many billions of dollars have been paid to producers to relieve take-or-pay obligations and renegotiate prices. The $8.7 billion filed for under Order No. 500 is only part of the total. Consumers are being billed for large portions of these payments, even though they receive no gas in return and were certainly not responsible for the contracts. It can happen again, so long as FERC and the Congress listen primarily to the large producers and the large industrial users.

NASUCA urges the Committee on Energy and Natural Resources not to approve S.783 as written.

Respectfully submitted,

Margaret Ann Samuels

Margaret Ann Samuels
Chair of NASUCA Gas Committee

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MAS/pf

CHEMICAL
MANUFACTURERS
ASSOCIATION

WRITTEN STATEMENT
OF THE
CHEMICAL MANUFACTURERS ASSOCIATION

ON

NATURAL GAS WELLHEAD PRICE
DECONTROL LEGISLATION

SUBMITTED TO THE
COMMITTEE ON ENERGY AND NATURAL RESOURCES
UNITED STATES SENATE

MAY 8, 1989

2501 M Street, NW
Washington, D.C. 20037
202-887-1100
Telex 89617 (CMA WSH)

WRITTEN STATEMENT OF
THE CHEMICAL MANUFACTURERS ASSOCIATION
ON
NATURAL GAS WELLHEAD PRICE
DECONTROL LEGISLATION

May 8, 1989

The Chemical Manufacturers Association (CMA) is pleased to offer the following comments on proposals to eliminate remaining statutory controls on wellhead natural gas prices. CMA strongly supports legislative efforts to terminate wellhead price controls. We believe that enactment of such legislation is in the interest of all segments of the natural gas market -- consumers, producers, pipelines, and distributors.

CMA is a non-profit trade association whose 171 member companies represent approximately 90 percent of the productive capacity of basic industrial chemicals in the United States. The U.S. chemical industry is extremely energy intensive and relies on natural gas supplies as both a feedstock (raw material) and as fuel for its operations. The industry accounts for about 10 percent of total U.S. natural gas consumption and over 25 percent of industrial gas consumption, making it the largest industrial user of natural gas. CMA member companies depend upon both the interstate and intrastate natural gas systems for their supplies of gas. Access to adequate supplies at competitive prices is essential to the continued economic viability of the U.S. chemical industry, which in 1988 recorded a net trade surplus of $12.4 billion.

CMA applauds the leadership of the Subcommittee for addressing this issue in the direct and unencumbered manner shown by the legislation being presented for consideration. It is exactly this straightforward approach that appeals to the member companies of CMA and demonstrates that complete wellhead decontrol of natural gas is possible. Any amendments or additional issues addressed by this legislation will raise the possibility of disagreement and diminish the chances of successfully terminating wellhead price controls. The benefits of greater long-term economic efficiency could be easily outweighed by potentially adverse amendments to the proposed legislation.

CMA members operate in highly competitive domestic and international markets. Moreover, one half of the industry's consumption of natural gas is non-substitutable. Therefore, any government action that impacts the price or availability of natural gas is of vital concern. To the extent that past policies, which have created artificially high energy prices, are replaced with policies that result in competitive natural gas prices and greater supply options, the chemical industry's ability to compete in both domestic and world markets is significantly enhanced.

During the early 1980's, CMA supported Congressional efforts to revise the Natural Gas Policy Act (NGPA) to remove obstacles to the development of, and access to, competitive future gas supplies. Those obstacles had manifest themselves as above-market wellhead prices for certain categories of natural gas dedicated to interstate commerce. Interstate pipeline gas costs, in many instances, became too high for large end users to bear and yet remain competitive.

In order to access gas supplies at more competitive rates, many industrial users began purchasing natural gas at the wellhead and transporting that gas over interstate and intrastate pipelines. This "self help" gas enabled chemical manufacturers to operate with lower fuel and feedstock costs. The process of direct purchases by end users became the forerunner of the more competitive natural gas market that exists today. An essential factor in its development was the consistent emphasis placed by the Federal Energy Regulatory Commission (FERC) on the importance of a competitive marketplace. Open access transportation, brought about by FERC Order Nos. 436 and 500, played a major role in helping consumers acquire reasonably priced supplies.

CMA continues to believe that complete wellhead decontrol will help assure adequate, competitive supplies of natural gas in the future. Competitive pricing will encourage additional exploration on fundamental economic bases, as opposed to development of non-economic supplies based solely on artificial, statutory prices. The signals sent to all segments of the gas market will be clearer, allowing efficient resource development, allocation, and consumption decisions to be made, thus benefiting the public interest.

The elimination of remaining wellhead price controls advances, and is consistent with, other Federal actions taken to increase competition in the natural gas industry. Over the last several years, FERC has taken a number of steps to allow competitive forces to operate more fully in the natural gas marketplace. Wellhead price decontrol furthers the process of creating a more competitive and efficient natural gas industry.

Congress should move forward expeditiously with the elimination of remaining wellhead price controls. This action will complete the job begun with phased-in decontrol under the NGPA, and will enhance the efficiencies that all industry segments have experienced over the last decade.

CMA would prefer that decontrol become effective upon the date of the legislation's enactment, but recognizes that the practical constraints of individual contracts may require a phased-in schedule for the elimination of remaining price controls. Nonetheless, Congress should move as quickly as practical to terminate all remaining controls on wellhead prices by a date certain. The gains from timely enactment of decontrol legislation will be realized for all segments of the natural gas market -- producers, pipelines, distributors and consumers. Complete decontrol of wellhead prices will enhance competition in natural gas markets and provide a sound basis for continued growth of all sectors in the U.S. economy.

EQUITABLE **RESOURCES**
ENERGY COMPANY

Grant Building
330 Grant Street
Pittsburgh, PA 15219
412/261-6000

May 5, 1989

The Honorable J. Bennett Johnston
Chairman
Committee on Energy and Natural Resources
364 Dirkson Building
United State Senate
Washington, D.C. 20510

Dear Senator Johnston:

Re: Natural Gas Decontrol and Tight Sands Drilling

As a leading producer of natural gas in the Appalachian Basin area, Equitable Resources Energy Company fully supports Congress' efforts to complete deregulation of natural gas at the wellhead. The marketplace has proven to be a much more effective regulator to the consumer's benefit.

However, deregulation may inadvertently destroy the tax incentive Congress previously established to encourage new tight sands gas drilling. This is the Section 29 tax credit which applies to such gas as well as gas produced from shale, coal seams, and other nonconventional sources.

Unless Congress modifies the law, decontrol eliminates any tax credit incentive for tight formation gas. A quirk in Section 29 now requires that tight formation gas be price regulated. We think this requirement serves no purpose today. It only deters new tight formation drilling and penalizes the prior drilling which has occurred. We ask your help on this issue and urge passage of bills like S.343 and S.425 which would restore and extend the credit for tight formation gas.

A second concern we have relates to the proposed Technical and Conforming Amendments found in Section 3 of the decontrol legislation. They would repeal the established procedure to qualify a gas well as a tight formation or other nonconventional source under Section 503 of the Natural Gas Policy Act of 1978. This same procedure is also used to qualify a well for Section 29 credits. To avoid disruption under Section 29, we believe Congress should retain Section 503 or adopt a substitute version.

For Equitable and many other producers, the Section 29 credit has often been the key economic factor in deciding to drill tight formation and other nonconventional gas wells. As you know, the relatively higher costs and production risks involved make these wells less attractive to drill. Developing these resources is important for reducing the Nation's reliance on foreign energy as the attached assessment from the Department of Energy shows. Of the remaining recoverable gas reserves in the lower 48 states, approximately 24.5% or 259 Tcf lies in nonconventional sources, primarily low-permeability tight formation reservoirs.

In recent years, we have seen a precipitous drop in new drilling while at the same time imports have surged again to 40% or more of domestic demand. We think these are compelling reasons why the Section 29 tax credit needs to be restored and extended for tight formation gas. Congress designed the credit to be fair to both producers and consumers. It phases out as market prices rise and generally keeps gas costs lower by making more local production available. This stimulates jobs, revenues, and other development in the local community.

We thank you for the opportunity to submit these comments.

Yours truly,

J.C. Bertges

J. C. Bertges
President

Advance Copy

AN ASSESSMENT OF THE NATURAL GAS RESOURCE BASE OF THE UNITED STATES

May 1988

Prepared for:
U.S. Department of Energy
Office of Policy, Planning & Analysis

TABLE 1. TOTAL UNITED STATES GAS RESERVES AND RESOURCES ASSESSED

	TECHNICALLY RECOVERABLE GAS, Tcf*	RECOVERABLE GAS BY PRICE**	
		<$3./Mcf	$3.-5./Mcf
LOWER 48 (Conventional)			
PROVED RESERVES, 12/31/86, ONSHORE AND OFFSHORE	159	159	...
INFERRED RESERVES/ PROBABLE RESOURCES, 12/31/86, ONSHORE	85	85	...
INFERRED RESERVES, 12/31/86, OFFSHORE	23	23	...
EXTENDED RESERVE GROWTH IN NONASSOCIATED FIELDS, ONSHORE	119	56	18
GAS RESOURCES ASSOCIATED WITH OIL RESERVE GROWTH***	61	30	11
UNDISCOVERED ONSHORE RESOURCES	219	88	59
UNDISCOVERED OFFSHORE RESOURCES****	134	54	28
SUBTOTAL	800	495	116
LOWER 48 (Unconventional)			
GAS IN LOW-PERMEABILITY RESERVOIRS	180	70	49
COALBED METHANE	48	8	4
SHALE GAS	31	10	5
SUBTOTAL	1,059	583	174
ALASKA			
ALASKA: RESERVES	33	7#	0
ALASKA INFERRED RESERVES (COOK INLET AREA)	3	3	0
ALASKA UNDISCOVERED, ONSHORE AND OFFSHORE	93	2#	2#
SUBTOTAL	1,188	595	176
TOTAL	1,188	595	176

*Volumes of gas judged recoverable with existing technology

**Volumes of gas (Tcf) judged recoverable with existing technology by Review Panel at wellhead prices shown (1987$)

***Judged at oil prices of <$24./bbl and $24.-40./bbl

****Outer Continental Shelf

#Component in southern Alaska

PGC PROCESS GAS CONSUMERS GROUP · THE PENNSYLVANIA BUILDING
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WASHINGTON, D.C. 20004-2404
(202) 383-0444

BEFORE THE

COMMITTEE ON ENERGY AND NATURAL RESOURCES

UNITED STATES SENATE

STATEMENT OF

THE PROCESS GAS CONSUMERS GROUP

MAY 8, 1989

STATEMENT OF THE PROCESS GAS CONSUMERS GROUP BEFORE THE SENATE ENERGY & NATURAL RESOURCES COMMITTEE

PGC is an association of 18 industrial consumers of natural gas, organized to promote the development and adoption of coordinated, rational, and consistent federal and state policies with respect to gas service to industrial process gas users. PGC members own and operate hundreds of plants in virtually every state in the nation. A list of our members is attached as Appendix 1.

Many industrials are energy intensive companies that individually spend as much as $200 million per year for their natural gas needs. For example, PGC's members consume natural gas in manufacturing applications, including process, nonprocess, and boiler uses, and from our perspective, there are two paramount natural gas issues: (1) security of supply and (2) price.

Security of supply is very important to us because, in our process gas uses, we do not have economically or technologically feasible alternative fuels. These process uses include, for example, applications which require the precise temperature controls and flame characteristics of gas or which must avoid contamination of the product from the burning of the fuel. Thus, these uses, which constitute a large percentage of PGC's consumption, cannot be switched to petroleum or other fuels.

Price is very important because natural gas, as with other inputs into the manufacturing process, presents costs which, in many cases may not be recoverable by companies in the prices charged for their products.

I. WELLHEAD DEREGULATION

Industrial users have consistently supported deregulation of natural gas at the wellhead. Our position has been reflected in the many appearances we have made before this Committee and other Congressional forums over the years. We have also generally supported the goals of FERC Order 451 which, early in 1987, allowed ceiling prices on certain old gas to increase in particular circumstances. It was widely recognized that at the time of that Order natural gas markets were not functioning rationally. Retail gas prices for system supply had remained at relatively stable high levels despite a substantial supply surplus. At the same time, many low-cost "old" gas wells remained shut-in and many producers of low-priced gas had been unable to increase output relative to higher-priced sellers. Consequently, while recognizing that legislative action would be the best solution, industrial users have supported administrative actions to bring rationality to wellhead gas markets.

We have favored deregulation because of our concern about reliability of supply. To the extent deregulation increases efficiency and rewards those producers who can sell more currently controlled gas when controls are removed, it will enhance our supply. With respect to our concern about the prices we pay for energy we would note the history of the last several years when wellhead prices have actually declined as less and less gas has been subject to controls.

The Members of this Committee who have co-sponsored S. 783 and S. 625 are to be commended for affording the nation the opportunity to finally achieve complete deregulation. PGC would prefer immediate deregulation. But, in the spirit of compromise, if a slightly longer period is necessary to achieve legislation, we would strongly urge the Committee to go forward. We are most vigorous, however, in our opposition to including in this bill any other matters, such as so-called anti-bypass legislation.

II. THE NEW GAS MARKET - FERC's ORDER 436/500

In 1986, PGC's last appearance on this subject before this Committee, we stated that the gas market was characterized by wildly disparate prices at the wellhead -- some far below "market clearing" and others substantially above it. Notwithstanding falling oil prices, pipelines had continued to purchase expensive gas even though their own sales rates were higher than a free marketplace would permit. This situation was exacerbated by the significant barriers that existed, in the absence of wide-spread pipeline acceptance of contract carriage, to end user access to lower-priced supplies -- barriers which also prevented producers from selling their lower-priced supplies into market, thus depriving them of much needed cash flow to encourage future drilling.

With the urging of industrial groups, FERC had concluded that outmoded regulation of the gas industry and lack of non-discriminatory access to gas transportation was inhibiting consumers' receipt of competitive benefits which deregulated gas prices should bring. FERC issued a landmark rule designed to encourage non-discriminatory access to interstate pipeline transportation of natural gas and fair, cost-based and competitive rates for such transportation -- Order No. 436, Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol. Order 436 subsequently went through several modifications and ultimately, in response to federal court action, was reissued as Order No. 500.

Orders 436 and 500 have substantially altered the regulation of the natural gas industry. Through nondiscriminatory transportation provisions, great progress has been made in giving local distribution companies ("LDCs") and users access to new gas sellers and supplies at competitive prices. As shown in Attachment 2, these Orders have resulted in a major transformation of the natural gas market. Almost 75% of the gas currently moving through the interstate pipeline system is transportation gas -- gas owned by others than the pipeline. In 1985, by contrast, only 36% of the total pipeline throughput was transportation gas. In this changed marketplace, producers have gained access to new markets and reduced their vulnerability to shut-ins. At the same time, all consumers are receiving the benefits of lower burner tip prices. In the long run, by removing significant obstacles imposed in the past both by regulation and by the pipelines themselves, these landmark Orders are helping to bring about a much more competitive natural gas market in which producers, LDCs, and consumers can transport gas at more reasonable prices.

III. THE NEW GAS MARKET - BENEFITS FOR ALL CONSUMERS

Despite an increasing percentage of decontrolled gas under the NGPA phase out of controls and the replacement by new uncontrolled wells of old depleting controlled wells, average wellhead prices have, according to the Energy Information Administration, substantially declined from a high of $2.60 per Mcf in 1984 to approximately $1.70 per Mcf currently. As shown in Attachment 3, average prices to residential consumers in 1984 ranged from $6.00 to over $7.00; today those prices are in the $5.00 to $6.00 range.

In at least two respects, industrial users have had a substantial role in bringing these benefits of lower gas prices to all consumers.

First, it was the industrial user community that led the successful efforts to open up the interstate pipeline system to nondiscriminatory transportation thus allowing local utilities to search for the cheapest gas supplies on behalf of residential and other consumers. The result of our success has been downward pressure on above-market wellhead prices and on excessive pipeline rates. Open access transportation, or contract carriage, has spread cheap decontrolled supplies evenly to both large and small purchasers.

Second, industrials have developed during the 1980s a wide range of dual fired capability for many of their uses, particularly for boiler fuel applications. When industrial boilers switch from gas to oil during the winter heating season, additional gas supplies are available for other uses -- holding down prices for the residential consumers. These interruptible industrial uses are driven primarily by price, and industrials with dual fuel capability have firmly ingrained into the energy market the principle that gas prices must be disciplined by the price of alternate fuels such as oil.

Without these actions by industrials, residentials might well be paying significantly more than they are now - perhaps as much as $1/Mcf more. The decline in residential prices shown in Attachment 3 that has occurred with the changes in the natural gas market, such as the advent of contract carriage, amounts to billions of dollars of savings to this consumer class. The perverse system of wellhead controls that existed in the late 70s and early 80s had resulted in shutting in cheap gas and selling costly supplies, which was harmful to residentials and other consumers as well. Partial removal of market-constraining wellhead controls, accompanied by the development of the current carriage system and the refusal by industrials to pay prices above alternative fuel rates for interruptible service have all helped to constrain gas rates -- for the benefit of all consumers.

CONCLUSION

Natural gas prices have decreased in the last several years as more and more gas has been deregulated. The efforts of industrial users to establish nondiscriminatory transportation and to create dual fuel fired capability for interruptible uses has helped moderate the prices all consumers pay for gas.

Industrial users support total deregulation of natural gas at the wellhead and desire that it be made effective as quickly as possible. We strongly oppose the inclusion of any additional issues such as anti-bypass.

We appreciate the opportunity to present our views on this most important subject to the Committee and will be pleased to discuss these matters further with Committee Members and staff.

Appendix 1

Alcan Aluminum Corporation
Aluminum Company of America
American National Can Company
Armco, Inc.
Bethlehem Steel Corporation
Carpenter Technology Corporation
Chrysler Corporation
Cone Mills Corporation
Corning Glass Works
Eaton Corporation
Ford Motor Company
General Motors Corporation
LTV Steel Company
National Steel Corporation
Owens-Corning Fiberglas Corporation
Owens-Illinois, Inc.
PPG Industries, Inc.
The Procter & Gamble Company

Statement of
C. William Cooper, Chairman
United Distribution Companies

on

S.783, THE NATURAL GAS WELLHEAD DECONTROL ACT OF 1989

Before the
UNITED STATES SENATE
COMMITTEE ON ENERGY AND NATURAL RESOURCES

MAY 8, 1989

My name is C. William Cooper and I am Chairman of United Distribution Companies. United Distribution Companies or "UDC" is an ad hoc group of organizations which provide retail natural gas distribution service throughout the Midwestern and Northeastern regions of the United States to more than 10,900,000 residential, commercial and industrial consumers. In the aggregate, UDC members account for approximately twenty-five (25) percent of the total retail natural gas service rendered in the United States. The members of UDC are vitally interested in S.783, the Natural Gas Wellhead Decontrol Act of 1989.

Since UDC was not included as a witness to take part in the May 8, 1989 Committee hearing, I request that this Statement be incorporated into and made part of the record of this Committee's proceedings on S. 783. Moreover, due to the importance of this legislation, I request that an additional day of hearings be scheduled by the Committee.

The title of S. 783 discloses its primary objective, namely: to remove federal price controls applicable to first sales of natural gas. However, removal of federal price controls is not the sole--or perhaps even the most important--statutory change accomplished by S.783. The key change is set forth in Section 7(a) of the bill, which states that the provisions of the Natural Gas Act and the jurisdiction of the Federal Energy Regulatory Commission "shall not apply solely by reason of any first sale of natural gas which is committed or dedicated to interstate commerce as of the day before the date of enactment... and which is not subject to a maximum lawful price...."

Let me delineate very clearly the exact contours of UDC's position on S.783 so that there is no confusion over UDC's position. UDC can only support S.783 (and the House Bill, H.R. 1722), if the legislation does not alter or affect in any way the service obligations of interstate natural gas pipelines to their distribution utility customers. Thus, if pipelines had advised UDC members that the removal of Natural Gas Act jurisdiction over first sales of committed or dedicated gas would impair the pipelines' ability to meet their service commitments to utilities, UDC would have opposed this legislation and would have made every effort to block its passage. Similarly, UDC will oppose any future action by pipelines to use S.783, H.R. 1722 or any legislative or regulatory action as a vehicle to remove Natural Gas Act jurisdiction over pipeline sales service obligations.

The bottom line is that UDC simply cannot support legislative or regulatory action that removes or reduces the authority of the Federal Energy Regulatory Commission to scrutinize on a case-specific basis, with appropriate factual inquiry, any proposed abandonment of pipeline sales service obligations. These obligations are essential to the ability of gas distributors to provide reliable, reasonably priced gas service to consumers. Legislative or regulatory action that undercuts this essential service obligation runs counter to the Natural Gas Act consumer protection objective, designed to give consumers a " . . . complete, permanent and effective bond of protection from excessive rates and charges . . ." Atlantic Refining Co. v. Public Service Commission of the State of New York, 360 U.S. 378, 388 (1959).

UDC's concern over the need to preserve the integrity of pipeline sales service obligation is not abstract or remote. As recently as November 1988, the Interstate Natural Gas Association of America ("INGAA"), the trade association for interstate natural gas pipelines, filed a petition for rulemaking with the Federal Energy Regulatory Commission to do away with the pipelines' sales service obligations. INGAA specifically requested that the Commission establish procedures under which pipelines would be freed from their sales service obligations--with no Commission review or approval--in cases where pipelines and their customers do not "negotiate" new or extended gas sales service agreements at the time existing sales service contracts expire.

UDC filed its opposition to the INGAA petition in December 1988. UDC pointed out that INGAA's proposal violated the consumer protection mandate of the Natural Gas Act by giving pipelines virtually unfettered discretion to dictate the terms and conditions under which pipelines would continue to render sales service at all to distributors and other pipeline customers. Thus, unless pipeline customers are willing to meet pipelines' terms and conditions, customers' needs are abandoned with no federal oversight.

A major grounds for UDC's opposition to INGAA's rulemaking proposal is that the natural gas market is not a classic free market. As UDC noted in its opposition, only some of the "players" in the Nation's gas market, such as certain large industrial consumers and producers of natural gas, can make day-to-day decisions without the constraint of comprehensive governmental oversight. INGAA's rulemaking petition, however, asked the Commission to overlook this market reality.[1]

The fact is that natural gas distribution utilities--which are a vital link between consumers and producer/pipeline markets -- remain fully regulated by state or local governmental authorities. And, it is the continuation of state or local regulation over gas distributors that virtually ties the hands of distributors in their efforts to deal with pipelines in setting the terms and conditions of the pipelines' sales service commitment. Distributors do not have the option to take or leave pipeline service; they need pipeline service to meet their obligation to consumers, particularly the high priority residential consumers that are completely dependent on retail gas distribution service. Significantly, nothing in S.783 or H.R. 1722 changes this competitive posture of the natural gas market.

UDC believes that it is essential for this Committee to review S.783 in light of true market conditions so that the purported benefits of price decontrol to the wellhead market are not thought to be equally applicable to the pipelines' sales service obligation. Specifically, UDC fears that pipelines may seek to rely on S.783, if enacted, as justification for removal of federal control over pipeline sales service obligations.

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[1] To date, the Commission has taken no action on INGAA's petition, docketed by the Commission as RM89-1-000.

UDC recognizes that S.783, on its face, does not authorize any changes to pipeline sales service obligations. UDC's concern, however, is that pipelines will attempt to "bootstrap" the removal of federal jurisdiction over first sales accomplished by S.783 to pipeline sales service obligations. UDC's concern is not unfounded. Indeed, INGAA based its November 1988 rulemaking petition chiefly on the Commission's action in Order No. 490 -- a rulemaking where the Commission granted first sellers of natural gas authority to automatically abandon their sales service obligation upon contract expiration, termination or modification.

UDC does not believe that any sound "parallel" can be drawn between pipeline sales service obligations and "first sales" by producers. Thus, UDC does not believe that the action taken by the Commission in Order No. 490, any more than the action proposed by S.783, can logically or lawfully be extended to the pipelines' sales service obligation.

Due to the importance of ensuring the continued viability of the pipelines' sales service to consumers who are dependent upon that service, and the fact that the pipeline industry already has tried to draw a parallel between first sales by producers and pipeline sales service, UDC urges this

Committee to make clear in its Committee Report on S.783-- should the bill be reported out of Committee -- that S.783 does not change federal jurisdiction over pipeline sales service obligations. In short, UDC asks this Committee to clarify in its Committee Report and any subsequent Conference Report that the full scope of Natural Gas Act authority, particularly the abandonment provisions of Section 7(b) of the Natural Gas Act, will remain fully applicable to regulated sales service by pipelines.

I would like to thank the Committee for the opportunity to present testimony on this vitally important issue.

TESTIMONY OF DR. J. READ HOLLAND ON BEHALF OF THE COALBED METHANE ASSOCIATION OF ALABAMA

Before the Committee on Energy
and Natural Resources

United States Senate

Washington, D.C.
May 8, 1989

EXECUTIVE SUMMARY OF HOLLAND TESTIMONY

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1. D.O.E. estimates that recoverable reserves of coalbed methane in the United States could exceed 90 trillion cubic feet. The advancement of existing technologies and emergence of new technologies continue to make coalbed methane production increasingly effective and economically practicable.

2. Coalbed methane is an increasingly important element of domestic natural gas production, with 1987 production totalling 100 trillion Btu.

3. Congress has previously supported, and continues to support, the development of coalbed methane production and production of fuels from other non-conventional sources. That support is manifested by the tax credits in Section 29 of the Internal Revenue Code of 1986, as amended.

4. The natural gas decontrol proposals under consideration by the Committee contain a "conforming and technical amendment" that would unintentionally erect a substantial technical impediment to the continued utilization of the Section 29 credits for coalbed methane production.

5. The technical and conforming language of the decontrol proposals should be altered slightly so that the Congressional intent to foster the production of coalbed methane would not be thwarted, and the consensus on natural gas decontrol would not be threatened.

TESTIMONY OF DR. HOLLAND

INTRODUCTION

Mr. Chairman, members of the Committee, I am Dr. J. Read Holland, Chairman of the Coalbed Methane Association of Alabama. 1/ I appear on behalf of the Association to alert the Committee to an adverse and unintended effect of the language in the natural gas decontrol proposals currently under consideration by the Committee. 2/ Before I begin I want to make clear that the Association supports decontrol of natural gas, and nothing I

1/ The Coalbed Methane Association of Alabama was incorporated in June 1986 to represent Alabama's coalbed methane industry. The Association is currently comprised of 50 members, who are operators of coalbed methane wells in Alabama or who otherwise participate in the coalbed methane industry. From its beginning, the Association has been concerned with facilitating the development of improved operational techniques and environmental practices for the industry. The objectives and goals of the group include:
(1) representing the interests of the Association with local, state and federal governments; (2) informing the public of the nature and importance of coalbed methane;
(3) promoting the conservation of methane resources and the orderly use and development of methane;
(4) enhancing the safety of underground mining by recovery and capture of methane from coal;
(5) promoting sound practices among the industry to protect the environment; and (6) supporting and encouraging research and development on coalbed methane.

2/ "Decontrol proposals," as used in this testimony, means S. 625, S. 783 and H.R. 1722.

say should be construed as opposition to decontrol. I submit this testimony simply to focus the Committee's attention on language in the decontrol proposals that would erect a substantial obstacle to continued utilization of certain tax credits -- tax credits that are key to the continued development of coalbed methane and other important fuels produced from non-conventional sources.

COALBED METHANE

Let me begin by introducing coalbed methane. Coalbed methane is a term used to describe occluded natural gas found in and amongst coal reserves. Incidentally, coalbed methane is already price deregulated and would not be affected, at least in the regulated price sense, by the pending decontrol proposals. Until relatively recently, gas found in coalbeds was viewed mostly as a dangerous nuisance. However, in the past decade, the advancement of existing technologies combined with the development of new technologies has made recovery of coalbed methane more effective and more economically practicable.

The primary method of recovering coalbed methane is by drilling, either vertically or horizontally, into coalbeds to release gas trapped in seams of the coal. Often the coal seam will be saturated with water that must be pumped out in order to allow the gas to escape. Because of the shape of most coalbeds, horizontal drilling is often the most effective means of recovery. Technological advancements within the past decade have made long (1,000 feet or more), precisely steered drainholes nearly routine. Among the other techniques used for coalbed methane recovery is tapping into the residue left in coal mines which have been mined by "longwall" techniques. Using this technique, coal is removed from large areas of the coalbed and the roof of the mine is left to collapse after the mining is complete. The fallout from the collapse of the roof and the residue from the mining emit methane which, in some cases, may be recovered and produced commercially.

While significant technological advances in coalbed methane recovery have been made, continued development will be needed to assure that the vast reserves of coalbed methane can be made available to the domestic gas market. Procedures for "fracking," or fracturing coal seams to enhance permeability (which allows the methane to escape), continue to be improved and are critical to enhanced coalbed methane recovery. Improved "fracking" techniques may also be a key to more efficient procedures for capturing released methane. In addition, there is hope that improved multi-directional drilling techniques may allow a combination of horizontal and vertical drilling techniques to be used to track asymmetrical coal seams. Another major concern is the continued development of environmental technology needed to safely dispose of wastes (primarily water) generated by coalbed methane drilling.

Coalbed methane exists virtually everywhere that substantial reserves of coal exist. While estimates vary widely, the Department of Energy has estimated that as much as 90 trillion cubic feet of recoverable coalbed methane exist in the United States. 3/ Production of coalbed methane is on the rise, and the Energy Information Administration estimates that there are currently 50 to 60 producing fields in the United States. Nearly 200 coalbed methane wells were drilled in 1987 and the Gas Research Institute ("G.R.I.") has estimated that twice as many were drilled in 1988. 4/ Domestic coalbed methane production totalled 100 trillion Btu in 1987, and the G.R.I. estimates that production will double by 2010. 5/ In 1988, over 500 coalbed methane wells were permitted for drilling in Alabama alone.

There are currently at least six basins in the United States where there is significant coalbed methane production activity. Those basins include areas in the

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3/ Several coalbed methane studies are summarized in an article by David Murchison entitled "Status of Coalbed Methane Recovery in the United States." The article was published in the Energy Information Administration publication, Natural Gas Monthly, September 1988, page 3.

4/ Gas Research Institute, "Policy Implications of the 1988 GRI Baseline Projections of U.S. Energy Supply and Demand to 2010," page 5.

5/ Gas Research Institute, "1988 GRI Baseline Projection of U.S. Energy Supply and Demand to 2010," page 45.

states of Alabama, Colorado, Kentucky, Maryland, Mississippi, New Mexico, Ohio, Pennsylvania, Washington and West Virginia. 6/ Alabama is one of the most active areas for production of coalbed methane. We produced nearly 20 billion cubic feet of coalbed gas in Alabama in 1988, and we predict production in 1989 will total 50 billion cubic feet. There were 539 active wells producing coalbed methane in Alabama as of February 1989, and those wells are owned by at least ten different companies. Although it is difficult to quantify the degree to which the tax credit may have influenced decisions to proceed with drilling programs, it is certainly true that in an atmosphere of declining prices for natural gas the credit has provided significant incentives for producers to develop and test the viability of advancements in production technology. Thus, due at least in part to the incentives provided by Section 29, production of coalbed methane is expected to have an impact of $234,000,000 on the Alabama economy alone in 1989, and that impact will grow in the future. 7/

6/ In addition, there are "less active basins" in the states of Arkansas, Illinois, Indiana, Montana, Oklahoma, Tennessee, Utah, Virginia and Wyoming. Murchison, Natural Gas Monthly, September 1988, pages 6-9.

7/ J.R. Holland, *et al.*, "Projected Economic Impact of Acclerated Coalbed Methane Development, Black Warrior Basin," April 1989, 1989 Coalbed Methane Symposium, Tuscaloosa, Alabama.

CONGRESSIONAL SUPPORT FOR COALBED METHANE

Congress has repeatedly recognized the importance of the development of coalbed methane and other fuels produced from non-conventional sources by providing tax incentives to encourage such development. Several members of this Committee have been among the most ardent supporters of those tax credits. As recently as last session, Congress reiterated its historical support for non-conventional fuel source tax credits by extending the credits in Section 29 of the Internal Revenue Code of 1986, as amended ("Code"). Section 29 provides a tax credit for "qualified" fuels, which include coalbed methane and gas produced from tight formations, Devonian shale, geopressurized brine and biomass. Under Code Section 29(c)(2), the determination of whether coalbed methane and other fuels are "qualified" is based upon criteria set forth in Section 503 of the Natural Gas Policy Act of 1978 ("NGPA"). 8/

The Section 29 tax credits are critical to the continued development of coalbed methane and other qualified fuels. Much of the technology development that I outlined above has occurred since the enactment of, and at least partially because of, the incentives provided in Section 29. Further technological development is needed to assure that

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8/ Under Code Section 29(f), the credit is available for qualified fuels which are produced from wells drilled or facilities placed in service after December 31, 1979, and before January 1, 1991.

coalbed methane will be a viable resource to meet future domestic energy needs. Congress has recognized these facts, and as a result, the tax credits continue to enjoy significant Congressional support. There are at least six proposals presently pending in either the House or the Senate that extend the Section 29 tax credit beyond January 1, 1993 -- the date of final decontrol for all natural gas and for the repeal of Section 503 of NGPA under the current proposals. 9/ Many of the sponsors and strong supporters of the bills to extend the tax credit are also supporters of the natural gas decontrol proposals now before the Committee.

THE UNINTENDED THREAT TO COALBED METHANE PRODUCTION

Unfortunately, the viability of the current Section 29 credit is unintentionally threatened by the decontrol proposals pending before this Committee. Section 103(b) of S. 625, and Sections 3(b)(5) of S. 783 and H.R. 1722, provide for the repeal of Section 503 of the NGPA. 10/ NGPA Section 503 establishes fuel category criteria, and its repeal is not necessary to decontrol.

9/ The pending legislative proposals to extend the Section 29 credit are: S. 234, S. 343, S. 449, H.R. 658, H.R. 664 and H.R. 1476.

10/ S. 625 would repeal NGPA Sectin 503 immediately, while S. 783 and H.R. 1722 would repeal Section 503 effective January 1, 1993.

However, because Section 503 is the mechanism by which fuels become qualified for the tax credit, the section is very important to the mechanics of Code Section 29. If NGPA Section 503 is repealed, it will greatly complicate efforts currently underway to extend the tax credits. The absence of the "qualifying" procedure set forth in NGPA Section 503 will erect a substantial technical impediment to the continued utilization of Section 29 by coalbed methane producers.

I strongly suspect that the proponents of gas decontrol do not intend to do away with the Section 29 credits. The repeal of NGPA Section 503 is not essential for gas decontrol. In fact, all of the pending bills provide for the repeal of Section 503 as part of the "Technical and Conforming Amendments." The repeal of Section 503 apparently became part of the decontrol consensus because it was believed to be necessary as a technical matter.

This technical limitation to Section 29 would be an adverse and presumably unintended effect of the decontrol legislation. Limitations of the Section 29 credit would severely imbalance the economics of coalbed methane production, just when the production is beginning to increase dramatically, and at a time when Congress has again expressed its support for continued development of this abundant resource.

We respectfully suggest to the Committee that the Section 29 tax credits should not be inadvertently made obsolete by the enactment of gas decontrol. That result can be avoided by simply leaving NGPA Section 503 in place. As a safeguard for total gas decontrol, the bill could declare that Section 503 will have no impact on gas regulation. For example, Section 3(b)(5) of S. 783 could be amended to read: "(5) Section 503 shall have no force or effect for any purpose of Subtitle A of Title I of the Natural Gas Policy Act on and after January 1, 1993."

We believe that such an amendment would preserve the intent of Congress to foster the development and production of coalbed methane and other fuels from non-conventional sources in the United States, without threatening the consensus on natural gas decontrol and without changing the intended impact of decontrol.

UNITED STATES SENATE
BEFORE THE SENATE ENERGY COMMITTEE

STATEMENT OF EUGENE E. THREADGILL
REGARDING S. 783

My name is Eugene E. Threadgill, an attorney with offices at the Farragut Building, 900 17th St. N.W. Washington, D.C. 20006. For the past 35 years I have engaged in private practice, primarily in the energy field.

My first experience with the petroleum industry occurred in the years 1942-4 when I was employed as an economist by the Office of Price Administration analyzing the impact of gasoline rationing on the prices, demand for and supply of gasoline. In the period 1951-5 I was employed as an attorney with the Federal Power Commission where I litigated and wrote opinions in major pipeline rate cases.

Since 1955 I have been in private practice, during which time I have represented large and small gas producers, large and small natural gas pipelines, oil pipelines, local gas companies and municipal gas systems, and a competitive fuel association. In 1966 I published an article in the Public Utilities Fortnightly which predicted that if the FPC continued its efforts to regulate well-head prices on a utility approach instead of a market approach, investment would be driven from the producing industry and natural gas shortages would result. It took six years to prove my prediction correct. More recently I published an article in the Fortnightly identifying the abusive practices by producers who exploited the gas shortage to compel pipelines to enter into long-term take-or-pay contracts that the market would not have permitted had there been workable competition at the time.

With total deregulation, the wellhead market could be workably competitive, but the pending legislation should include the following proviso:

> Provided, that no contract for the first-sale of natural gas executed prior to the effective date of this Act shall be enforced against either party unless such party shall have ratified that contract subsequent to the effective date hereof. Any party wishing to rescind a previously effective contract shall give the other party ninety days notice to that effect. If no party gives the other party such notice within one year from the effective date hereof, both parties shall be deemed to have ratified their contract.

EFFECT ON WELLHEAD PRICES - The inclusion of such a provision in the deregulation bill would raise the prices of "spot market" gas from the present $1.50 level to the real market value of about $2.00 per MCF. At present a significant amount of the market value of gas is being siphoned off to producers with 1980-82 long-term take-or-pay contracts with $4.00 to $5.00 prices. The sellers of recently discovered gas are subsidizing those take-or-pay above-market-value contracts by selling gas at distress prices. Those producers which executed contracts long ago which compel them to continue to deliver gas at prices well below market value could bring their prices up to presnt market levels. This would provide them with increased revenues to engage in expanded exploration. The incentive for expanded drilling would be increased if all gas prices were brought up or down to market values that send correct signals between suppliers and consumers.

EFFECT ON PIPELINES - The opportunity to rescind gas purchase contracts would allow all pipelines which are interested in converting to common carrier status to do so promply without inpediment. Although the FERC has been trying to compel pipelines to shed their merchant function, and many pipelines would be delighted to become transporters, most pipelines cannot do so because they are bound by long term contracts representing significant proportions of their capacity. A provision allowing either party to pre-deregulation contracts to rescind those contracts would allow any pipeline desiring to convert to common or contract carrier status to do so without the immense burden of take-or-pay obligations.

EFFECT ON CONSUMERS - There should be no immediate effect on consumers. The volume of gas presently flowing would continue to flow. The pipelines would continue to transport those volumes to markets. The prices at the wellhead would be realigned to a market value that should be similar to the present average cost of gas at the wellhead. Producers and marketers would gain direct access to markets; pipelines would set their transportation rates at levels designed to maximize throughputs. Producers presently selling at depressed spot market values or under old low priced contracts would have enhanced ability and incentive to engage in exploration to find new reserves. Those producers which are receiving above market-values for their gas would lose their ability to dominate production. Competition for potential gas producing properties would be enhanced.

In the long run, there would be greater security of supply and adequate transportation services at competitive prices to meet market needs. The gas consuming public and the industrial gas consumers would be assured that long run supplies would be provided to meet market demands.

These suggestions are offered not by someone representing a special interest but by someone who has worked in the industry for a professional lifetime and who would like to see that industry brought out of the shadows of ill-conceived regulation, including NGPA regulation, into the modern, truly competitive world.

This testimony is submitted for the record, and if any member of the Committee should desire my testimony or amplification of my recommendations, I would be pleased to provide such additional information as might be useful to the Committee.

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